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# The Activist Shareholders' Migration to Europe: How the United States Can Retain Its Wandering Investors

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# THE ACTIVIST SHAREHOLDERS' MIGRATION TO EUROPE: HOW THE UNITED STATES CAN RETAIN ITS WANDERING INVESTORS

## INTRODUCTION

On August 13, 2013, activist investor Carl Icahn tweeted, “We currently have a large position in APPLE. We believe the company to be extremely undervalued.”<sup>1</sup> Apple’s market value increased by \$17 billion within hours because of Icahn’s tweet composed of less than 140 characters.<sup>2</sup> Less than two months later, Icahn again disclosed over Twitter that he was discussing the possibility of a \$150 billion share buyback plan with the CEO of Apple.<sup>3</sup> Apple’s market capitalization then increased by \$1 billion, causing the overall value of the company to reach \$443 billion.<sup>4</sup> For reasons such as this, “[s]hareholders should be tickled to death when [Carl Icahn] shows up.”<sup>5</sup>

Icahn, as well as other activist shareholders, look for publicly traded corporations that may be poorly managed or undervalued and then use their rights as shareholders to push for changes in the corporations.<sup>6</sup> Examples of these changes include higher dividend payments, share buybacks, cost cuts, and changes in management.<sup>7</sup> While activist shareholders have often been scrutinized, the fact that their campaigns have provided significant benefits to corporations and their shareholders is undeniable.<sup>8</sup> For example, the stocks of corporations that were targeted by activists between 2009 and 2013 rose nearly

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1. Carl Icahn (@Carl\_C\_Icahn), TWITTER (Aug. 13, 2013, 11:21 AM), [https://twitter.com/carl\\_c\\_icaohn/status/367350206993399808](https://twitter.com/carl_c_icaohn/status/367350206993399808).

2. David Carr, *Using Twitter to Move the Markets*, N.Y. TIMES (Oct. 6, 2013), [http://www.nytimes.com/2013/10/07/business/media/using-twitter-to-move-the-markets.html?ref=global-home&\\_r=0](http://www.nytimes.com/2013/10/07/business/media/using-twitter-to-move-the-markets.html?ref=global-home&_r=0).

3. Carl Icahn (@Carl\_C\_Icahn), TWITTER (Oct. 1, 2013, 7:23 AM), [https://twitter.com/carl\\_c\\_icaohn/status/385047418284158976](https://twitter.com/carl_c_icaohn/status/385047418284158976).

4. Carr, *supra* note 2.

5. Stephen Foley, *Carl Icahn, Obsessive Activist Investor*, FIN. TIMES (Feb. 21, 2014, 6:44 PM), <http://www.ft.com/intl/cms/s/0/d4d05c84-9a54-11e3-8232-00144feab7de.html#axzz3z7pfn0RZ>.

6. Tara Lachapelle & Beth Jinks, *Predators Are Good for Stocks*, BLOOMBERG (Apr. 4, 2014, 1:19 PM), <http://www.bloomberg.com/bw/articles/2014-04-03/activist-investors-are-good-for-the-stock-price>.

7. *See id.*; *see also* Alexandra Stevenson, *No Barbarians at the Gate; Instead, a Force for Change*, N.Y. TIMES (Jan. 6, 2014, 6:42 PM), [http://dealbook.nytimes.com/2014/01/06/no-barbarians-at-the-gate-instead-a-force-for-change/?\\_r=0](http://dealbook.nytimes.com/2014/01/06/no-barbarians-at-the-gate-instead-a-force-for-change/?_r=0).

8. Stevenson, *supra* note 7.

forty-eight percent by the end of that period.<sup>9</sup> Activists may have just hit the tip of the iceberg in terms of their potential in America, but as of late, they have begun to launch more campaigns abroad than ever before.<sup>10</sup> In 2015 alone, 131 companies outside of the United States were targeted, which is a forty-seven percent increase from the previous year.<sup>11</sup> Numerous reasons have driven this move abroad, but a leading factor is the shareholder friendly corporate governance law found overseas.<sup>12</sup>

This Comment argues that the corporate governance system of the United States should be altered to reflect certain shareholder friendly policies that are embodied in the United Kingdom. Strict, mandatory regulations currently govern the United States, so the adoption of the shareholder friendly policies similar to Principles 5 and 6 of the UK Stewardship Code<sup>13</sup> and Section E of the UK Corporate Governance Code<sup>14</sup> would be beneficial to American activists. The already existing strict regulations would allow for investors to obtain all of the information they need in order to make respectable investments. The adoption of UK shareholder-friendly policies, in addition to the existing U.S. rules, would allow activist investors and other shareholders to work together to enact crucial changes in corporations more easily. By combining these policies, American activists would not feel the need to travel abroad to find more shareholder friendly laws. This Comment contends that the implementation would trigger a domino effect in the American market. The increase of shareholder friendly policies would allow shareholders to reap more benefits, thereby allowing corporations to maximize their profits as well. Overall, the incorporation of parts of the UK Codes into the American system would help activist shareholders generate even more beneficial changes in corporate America.

Part II of this Comment first explores the work of activist shareholders and the controversy behind their campaigns.<sup>15</sup> It then moves to identify some of the many benefits that activists can, and have, of-

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9. Lachapelle & Jinks, *supra* note 6.

10. Michael Flaherty & Sinead Cruise, *Shareholder Activism Grows Overseas as US Market Gets Crowded*, REUTERS (Aug. 31, 2015), <http://www.reuters.com/article/funds-activists-overseas-idUSL4N11342X20150831>.

11. *Id.*; see also Billy Bambrough, *The Revolution Will Be Monetised: Activist Investors Are Closing in on a Record Year*, CITY A.M. (Nov. 5, 2015, 12:02 AM), <http://www.cityam.com/228048/the-revolution-will-be-monetised-activist-investors-are-closing-in-on-a-record-year> (“Incidents of shareholders pushing for change in Europe have risen 126 per cent since 2010.”).

12. See Flaherty & Cruise, *supra* note 10.

13. UK STEWARDSHIP CODE (FIN. REPORTING COUNCIL 2012).

14. UK CORP. GOVERNANCE CODE (FIN. REPORTING COUNCIL 2016).

15. See *infra* notes 20–35 and accompanying text.

ferred to corporations.<sup>16</sup> Lastly, Part II explores the general corporate governance laws in both the United States and the United Kingdom.<sup>17</sup> Part III argues that certain aspects of the UK Corporate Governance Code and the UK Stewardship Code should be implemented into the United States corporate governance regime.<sup>18</sup> Part IV examines the impact that the implementation of these laws would have in the United States,<sup>19</sup> and Part V concludes that shareholders and corporations alike would benefit greatly from a merged legal system composed of both U.S. and UK policies.

## II. BACKGROUND

This Part describes the role of activist shareholders and the controversy surrounding their work. This Part then discusses the dissimilar versions of corporate governance laws found in the U.S. and the UK that affect activist shareholders.

### A. *The Controversial Activist Shareholder*

Shareholder activism involves attempts to bring about changes in corporations that are not currently pursuing “shareholder-wealth-maximizing goals.”<sup>20</sup> While there are numerous situations in which activist shareholders have been beneficial to corporations, reaching these goals can be a difficult task that requires activists to take actions that executives and the board of directors oppose.<sup>21</sup> For this reason, activists’ poor reputation as “corporate raiders” has been somewhat difficult to shake.<sup>22</sup> Since their emergence, many have viewed activists as a “cult of short-term shareholder[s]” that only aim to strip corporations for cash and assets.<sup>23</sup> During the 1980s, in a time referred to

16. See *infra* notes 36–70 and accompanying text.

17. See *infra* notes 71–150 and accompanying text.

18. See *infra* notes 151–296 and accompanying text.

19. See *infra* notes 297–339 and accompanying text.

20. Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227, 227 (1996).

21. James Kwak, *Markets Aren't that Stupid*, BASELINE SCENARIO (Aug. 12, 2013), <http://baseline-scenario.com/2013/08/12/markets-arent-that-stupid/> (“Entrenched CEOs and boards (and their lawyers) don’t like this because, well, they don’t like outsiders telling them what to do and stirring up shareholders to vote against them.”).

22. Stevenson, *supra* note 7 (“Once painted as greedy corporate raiders, they would amass large stakes in a company and, through brute force, push for changes in the company’s leadership and business practices.”).

23. *Capitalism’s Unlikely Heroes: Why Activist Investors Are Good for the Public Company*, ECONOMIST (Feb. 5, 2015, 11:57 AM), <http://www.economist.com/news/leaders/21642169-why-activist-investors-are-good-public-company-capitalisms-unlikely-heroes>; see also CAROLYN KAY BRANCATO, INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE: BEST PRACTICES FOR INCREASING CORPORATE VALUE 29 (1997).

as the “takeover wars,” activists had numerous resources at their disposal, which enabled them to be highly aggressive and self-interested while focusing primarily on short-term financial gains.<sup>24</sup> For example, investors engaged in “Saturday night special” raids, in which they would attempt to take over corporations via cash tender offers.<sup>25</sup> During these raids, investors would buy a majority of stock over the weekend, which in turn led to an almost inevitable takeover.<sup>26</sup> However, activists’ methods and goals have changed over time.<sup>27</sup>

Although raids of this kind no longer exist, many continue to challenge activist shareholders and their campaigns, refusing to forget the “corporate raider” nickname.<sup>28</sup> The opponents of shareholder activism, ranging from prominent authors and professors to business organizations and corporate lawyers, have continued to voice their objections to these campaigns over the years.<sup>29</sup> The primary argument opponents have championed against activism has been dubbed the “myopic-activists” claim.<sup>30</sup> Under this claim, “activist shareholders with short investment horizons . . . push for actions that are profitable in the short term but are detrimental to the long-term interests of companies and their long-term shareholders.”<sup>31</sup> The law firm Wachtell, Lipton, Rosen & Katz has launched numerous attacks on

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24. BRANCATO, *supra* note 23, at 95; see Margaret Isa, *Where, Oh Where, Have All the Corporate Raiders Gone?*, N.Y. TIMES (June 30, 1996), <http://www.nytimes.com/1996/06/30/business/where-oh-where-have-all-the-corporate-raiders-gone.html>.

25. BRANCATO, *supra* note 23, at 96.

26. Steven M. Davidoff, *The SEC and the Failure of Federal Takeover Regulation*, 34 FLA. ST. U. L. REV. 211, 216 (2007) (“The ‘Saturday Night Special’ was a favorite: in one form, a bidder would embark on a pre-offer buying raid to establish a substantial beachhead of ownership at a reduced price.”). Raiders took advantage of shareholders and provided them little time and little information before they could decide whether to sell or surrender their shares. See Andrew N. Nagel et al., *The Williams Act: A Truly “Modern” Assessment*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Oct. 22, 2011), <https://corpgov.law.harvard.edu/2011/10/22/the-williams-act-a-truly-modern-assessment/>.

27. Since the passage of the Williams Act of 1968, corporate management has been armed with weapons to oppose takeovers, such as poison pills and staggered board terms. See Nagel et al., *supra* note 26, at 1–2, 7.

28. Dunstan Prial, *Long-Term Reformers or Corporate Raiders: Today’s Activist Investors*, FOX BUS. (June 1, 2015), <http://www.foxbusiness.com/features/2015/05/29/long-term-reformers-or-corporate-raiders-today-activist-investors.html> (“Are they the corporate raiders of 1980s infamy . . . [o]r are they thoughtful corporate strategists . . . ? Perhaps these activists are a little bit of both.”).

29. Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1093–94 (2015).

30. *Id.* at 1087; see also Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459, 477 (2013).

31. Bebchuk et al., *The Long-Term Effects*, *supra* note 29, at 1087.

activists using this logic.<sup>32</sup> Martin Lipton, a founding partner, has been at the head of many of the attacks.<sup>33</sup> Lipton argues that studies portraying activist campaigns as beneficial are incorrect, as they do not take into account how campaigns often push for short-term steps at the expense of the corporations' long-term goals.<sup>34</sup> However, this argument does not go unopposed. For example, many proponents of activist campaigns argue that the myopic-activists claim fails because "a company's stock price at any moment incorporates market expectations about how it will perform for the rest of time, so it is already a long-term measure."<sup>35</sup> For this reason, it is impossible for an activist to only have short-term goals, as even short-term goals will ultimately affect a corporation in the future. To illustrate, the following Section describes some of the long-term benefits that activists can provide to a corporation and its shareholders.

### B. *The Benefit of Activist Campaigns to Corporations*

A change in the activists' agenda over the last two decades has increasingly led more people to drop the "corporate raider" name.<sup>36</sup> Instead, activists are now more commonly associated with increasing shareholder value.<sup>37</sup> Activists' goals are now different, as they no longer solely want to take control of a corporation in which they own shares, but instead seek to bring about operational, strategic, and governance changes that are beneficial to, and will create value for, shareholders.<sup>38</sup> Benefits arise when, for example, activists seek to return excess cash to shareholders, to restructure company assets by selling underachieving businesses and distributing the proceeds to shareholders, and to restructure corporate operations to generate greater profits.<sup>39</sup> Activists' methods of achieving their goals have also changed.<sup>40</sup>

32. Liz Hoffman, *Wachtell Launches Another Grenade in Activist Debate*, LAW360 (Aug. 26, 2013, 2:56 PM), <http://www.law360.com/articles/467671/wachtell-lobb-another-grenade-in-activist-debate>.

33. *Id.*

34. See Lachapelle & Jinks, *supra* note 6. See generally Martin Lipton, *Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Feb. 26, 2013), <http://corpgov.law.harvard.edu/2013/02/26/bite-the-apple-poison-the-apple-paralyze-the-company-wreck-the-economy/>.

35. Kwak, *supra* note 21.

36. Isa, *supra* note 24.

37. See Katelouzou, *supra* note 30, at 461–62; see also Charles Nathan, *Debunking Myths About Activist Investors*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Mar. 15, 2013), <http://corpgov.law.harvard.edu/2013/03/15/debunking-myths-about-activist-investors/> ("Activist investing is often a useful contributor to good corporate governance and a force for company implementation of strategies that enhance shareholder value.").

38. See Nagel et al., *supra* note 26, at 2.

39. Nathan, *supra* note 37.

Instead of using secretive tender offers, such as the “Saturday night specials,” activists gain only enough control to influence both shareholders and management to adopt their ideas for change.<sup>41</sup> While corporate raiders of the past purchased large masses of shares in order to obtain operational control, activist shareholders now only acquire enough shares to allow their voices to be heard.<sup>42</sup>

In response to Martin Lipton’s contention that activists do not lead to corporate improvement, Carl Icahn stated, “Marty Lipton is completely wrong. He’s been wrong for 30 years.”<sup>43</sup> Icahn supported this claim with evidence of numerous successful activist campaigns.<sup>44</sup> As minority shareholders, many activist shareholders have brought forth substantial and positive changes in corporate America. For example, in 2014, Jeff Smith of Starboard Value LP launched a campaign against Darden Restaurants, Inc. while owning less than ten percent of the company.<sup>45</sup> The campaign primarily focused on the fact that Darden had ignored shareholder recommendations and concerns by selling Red Lobster, and it also included a 300-page list of recommendations for improving the business.<sup>46</sup> The successful campaign resulted in replacing every member of Darden’s board of directors with individuals picked by Starboard Value LP.<sup>47</sup> James Mitarotonda, chairman and CEO of the activist investor group Barington Capital Group, stated that he was “extremely pleased that necessary changes have been made to Darden’s board and senior management team to pave the way for the implementation of new measures to enhance

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40. *Id.*

41. Nagel et al., *supra* note 26, at 8; see also Stephen Foley et al., *Activist Investors Learn to Mind Their Manners*, FIN. TIMES (Aug. 7, 2015, 7:26 PM), <http://www.ft.com/intl/cms/s/0/209f0700-3ce3-11e5-8613-07d16aad2152.html#axzz42AbZni1d> (“Many US activists now couch their demands as asking boards to ‘consider’ spin offs and to appoint ‘independent’ directors—rather than the activist himself—to the board. This sits well with other shareholders . . .”).

42. See Nagel et al., *supra* note 26, at 16–17; see also Nathan, *supra* note 37 (“Today, activist investors rarely seek equity stakes in target companies above 10%, and their financing comes not from the public debt or equity markets but rather through private hedge funds that they sponsor and manage.”).

43. Lachapelle & Jinks, *supra* note 6.

44. See *infra* notes 45–55 and accompanying text.

45. William D. Cohan, *Starboard Value’s Jeff Smith: The Investor CEOs Fear Most*, FORTUNE (Dec. 3, 2014, 7:40 PM), <http://fortune.com/2014/12/03/starboard-capitals-jeff-smith-activist-investor-darden-restaurants/>.

46. Alexandra Stevenson, *Activist Hedge Fund Starboard Succeeds in Replacing Darden Board*, N.Y. TIMES (Oct. 10, 2014, 10:42 AM), <http://dealbook.nytimes.com/2014/10/10/activist-hedge-fund-starboard-succeeds-in-replacing-darden-board/>.

47. *Id.*

shareholder value.”<sup>48</sup> The new board made strides in attempting to increase shareholder value while also approving a transaction that reduced Darden’s debt by approximately \$1 billion.<sup>49</sup> In another example, when Apple planned to have its shareholders vote on a proposal that would make it harder for the company to issue preferred shares,<sup>50</sup> David Einhorn of Greenlight Capital launched a campaign that forced Apple to return part of its \$137 billion cash reserve to shareholders through buybacks and dividend payments.<sup>51</sup> Furthermore, Bill Ackman of Pershing Square Capital Management used his campaign to break up Fortune Brands into two publicly traded companies in order to unlock value for shareholders.<sup>52</sup> Beam, one of the companies Fortune broke into, has a stock price that has climbed nearly twenty-four percent since it became independent<sup>53</sup> and was acquired for over \$13 billion.<sup>54</sup> Lastly, Daniel Loeb not only ousted Yahoo’s CEO, who had falsely claimed that he had a computer science degree, but also increased Yahoo’s stock price from approximately \$13 per share to \$29.11 per share as of 2013.<sup>55</sup>

Beyond these specific examples, empirical evidence also supports that there are benefits to activist participation. In response to myopic-activist claims, discussed above, that capital markets are often inefficient and that activists often have only short-term investment horizons,<sup>56</sup> Lucian A. Bebchuk,<sup>57</sup> Alon Brav,<sup>58</sup> and Wei Jiang<sup>59</sup> published

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48. Leslie Patton, *Starboard Wins All Seats on Darden’s Board*, BLOOMBERG (Oct. 10, 2014, 3:19 PM), <http://www.bloomberg.com/news/articles/2014-10-10/starboard-wins-all-12-seats-on-darden-s-board-after-proxy-fight>.

49. *Darden Announces Record and Distribution Dates for Spin-Off of Four Corners Property Trust, Inc.*, PR NEWswire (Oct. 21, 2015), <http://www.prnewswire.com/news-releases/darden-announces-record-and-distribution-dates-for-spin-off-of-four-corners-property-trust-inc-300164034.html>.

50. M.G., *Apple and Greenlight Capital: Einhorn, 1, Apple 0*, ECONOMIST (Feb. 22, 2013, 10:51 PM), <http://www.economist.com/blogs/schumpeter/2013/02/apple-and-greenlight-capital>.

51. *Id.*

52. Michael J. de la Merced, *Fortune Brands Plans a Three-Way Split*, N.Y. TIMES (Dec. 7, 2010, 9:39 PM), <http://dealbook.nytimes.com/2010/12/07/fortune-brands-to-split-up/>.

53. Michael J. de la Merced, *Thank Ackman for the Beam Deal*, N.Y. TIMES (Jan. 13, 2014, 8:02 AM), <http://dealbook.nytimes.com/2014/01/13/thank-bill-ackman-for-the-beam-deal/>.

54. Michael J. de la Merced & David Gelles, *My Old Osaka Home: Suntory of Japan to Buy Maker of Jim Beam*, N.Y. TIMES (Jan. 13, 2014, 7:20 AM), <http://dealbook.nytimes.com/2014/01/13/suntory-of-japan-to-buy-maker-of-jim-beam-for-13-6-billion/>.

55. Nathan Vardi, *Billionaire Dan Loeb Sells Most of His Yahoo Stock, Makes \$1 Billion*, FORBES (Jul. 22, 2013, 10:22 AM), <http://www.forbes.com/sites/nathanvardi/2013/07/22/billionaire-dan-loeb-sells-most-of-his-yahoo-stock-makes-1-billion/>.

56. Bebchuk et al., *The Long-Term Effects*, *supra* note 29, at 1087; Katelouzou, *supra* note 30, at 477.

57. James Barr Ames Professor of Law, Economics, and Finance; Director, Program on Corporate Governance, Harvard Law School.

58. Alon Brav Robert L. Dickens Professor, Duke University, Furqua School of Business.



a study concluding that these accusations are invalid.<sup>60</sup> The study used objective data, as opposed to many other studies that use self-reported impressions of activists and their campaigns.<sup>61</sup> Bebchuk, Brav, and Jiang analyzed approximately two thousand activist campaigns that occurred between 1994 and 2007, and they found no evidence that activist interventions are followed by short-term gains that come at the expense of long-term performance, as many opponents argue.<sup>62</sup> According to the study's findings, in the five years after activist intervention, corporations' valuations improved and shareholders continued to benefit from positive returns.<sup>63</sup> In furtherance of this study, Activist Insight cited that activist-targeted stocks outperform the S&P 500 by an average of 4.3% upon the activists' departure.<sup>64</sup> The price per share of Surmodics, Inc., for example, increased 119.1% within the twenty-two months after Starboard Value launched its campaign.<sup>65</sup> Seven months after Starboard's exit, the share price of this small healthcare corporation rose an additional 29.4%, permitting it to beat the S&P 500<sup>66</sup> by 18.5 percentage points.<sup>67</sup> Additionally, when JANA Partners pushed for a spin-off at Marathon Petroleum in 2011, Marathon shareholders enjoyed a 72% increase in share price in the fifteen months after the activists' departure.<sup>68</sup> Here, Marathon outperformed the S&P 500 by 53 percentage points.<sup>69</sup>

Data such as this has been used to convert the skeptics of activist campaigns to supporters. In fact, Lipton, a known opponent of ac-

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59. Arthur F. Burns Professor of Free and Competitive Enterprise, Columbia Business School.

60. Bebchuk et al., *The Long-Term Effects*, *supra* note 29, at 1096.

61. *Id.* at 1097 ("Martin Lipton, for example, wrote that his short-termism concerns are based on 'the decades of [his] firm's experience in advising corporations.' . . . Wachtell Lipton urged reliance on the 'depth of real-world experience' of corporate leaders rather than on empirical evidence.").

62. *Id.* at 1100, 1155.

63. *Id.* at 1111, 1134.

64. Press Release, Activist Insight, *Activists Leaving Companies in Good Shape* (May 9, 2013), <http://www.activistinsight.com/press/Activist%20Insight%20Press%20Release%20-%20good%20shape.pdf>.

65. *Id.*

66. "The S&P 500 stands for the Standard and Poor 500. It is a stock market index that tracks the 500 most widely held stocks on the New York Stock Exchange or NASDAQ. It seeks to represent the entire stock market by reflecting the risk and return of all large cap companies." Kimberly Amadeo, *What Does the S&P 500 Tell You About Stocks?*, BALANCE (Oct. 17, 2016), <https://www.thebalance.com/what-is-the-sandp-500-3305888>. An investor beats the S&P 500 when the investment has a greater return than the S&P index. Amy Fontinelle, *Is It Possible to Beat the Market?*, INVESTOPEDIA, <http://www.investopedia.com/ask/answers/12/beating-the-market.asp> (last visited Mar. 23, 2017).

67. Press Release, Activist Insight, *supra* note 64.

68. *Id.*

69. *Id.*

tivist campaigns, wrote a letter in which he stated that activists “have become respected members of the financial community . . . In most cases a corporation will be well advised to meet with the activist and discuss the activist’s criticisms and proposals.”<sup>70</sup> Although activists continue to be seen in a more favorable light, the corporate governance structure of the United States is still restricting their ability to work and generate changes in corporate America. The next Section describes the governance regime in which the activists work.

### C. Corporate Governance in the United States

Corporate governance is generally defined as a “set of control mechanisms and institutions which protect the suppliers of capital to a company.”<sup>71</sup> Although the definition of corporate governance shifts depending on the party, most agree that corporate governance is a means to benefit shareholders and increase their value.<sup>72</sup> While there is not one specific governing law, state law, in addition to the Securities Exchange Act of 1934,<sup>73</sup> the Sarbanes–Oxley Act of 2002 (SOX),<sup>74</sup> and the guidelines set forth in stock exchanges, such as the National Association of Securities Dealers Automated Quotations (NASDAQ) and the New York Stock Exchange (NYSE), are of importance to corporate governance in the United States.<sup>75</sup>

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70. Martin Lipton, *Some Lesson from DuPont-Trian*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Apr. 30, 2015), <http://corpgov.law.harvard.edu/2015/04/30/some-lessons-from-du-pont-trian/>; see Kurt Orzeck, *Wachtell Lipton Funder Suggests Settling with Activists*, LAW360 (Apr. 30, 2015, 8:51 PM), <http://www.law360.com/articles/650253/wachtell-lipton-founder-suggests-settling-with-activists> (“Lipton appeared to have changed, or at least softened, his position. He said corporations—even ones with ‘outstanding’ CEOs and boards of directors—would be well-advised to meet with activists and discuss their criticisms and proposals.”).

71. Shareholders are the suppliers of capital. GEOFFREY OWEN ET AL., *CORPORATE GOVERNANCE IN THE US AND EUROPE: WHERE ARE WE NOW?* 2 (2006); see also PETER ALEXIS GOUREVITCH & JAMES J. SHINN, *POLITICAL POWER AND CORPORATE CONTROL: THE NEW GLOBAL POLITICS OF CORPORATE GOVERNANCE* 3 (2005) (“These laws define the obligations of managers, the rights and duties of owners, the claims of shareholders, and the power of boards.”).

72. Abdul Ghafoor Awan & Muhammad Saeed Akhtar, *Problems of Corporate Governance in USA*, EUR. J. BUS. & INNOVATION RES., Aug. 2014, at 55, 56.

73. 15 U.S.C. §§ 78a–78qq (2012).

74. Pub. L. No. 107-204, 116 Stat. 745 (2002).

75. See *Corporate Governance: USA Versus Europe*, VALUEWALK (Jan. 7, 2013, 12:34 PM), <http://www.valuewalk.com/2013/01/corporate-governance-usa-versus-europe>; see also Adam Dowdney, *Corporate Governance in The UK and U.S. Comparison*, METRO. CORP. COUNS. (Dec. 1, 2005), <http://www.metrocorpcounsel.com/articles/6173/corporate-governance-uk-and-us-comparison>.

### 1. State Law and the Proxy Regulation Rules

While companies may choose to incorporate in any state, Delaware is the most favored state for incorporation.<sup>76</sup> In fact, more than half of the companies that make up the Fortune 500 are incorporated in Delaware.<sup>77</sup> This makes Delaware law the most commonly used state law for corporate matters.<sup>78</sup> Generally under state statutes, shareholders elect directors and vote on vital matters, directors watch officers and approve major corporate decisions, and officers run the company on a daily basis.<sup>79</sup> Shareholders' substantive rights under state law can be broken down into three areas: (1) shareholders can elect directors; (2) shareholders can approve changes in the contract between managers and shareholders; and (3) shareholders can approve major changes in a corporation's structure.<sup>80</sup> While state laws imply that shareholders have substantial rights, shareholders' control is very limited.<sup>81</sup> This is in part because directors have closer ties to a corporation's officers than to its shareholders,<sup>82</sup> and also because state laws impose strict procedural rules that negatively affect shareholders.<sup>83</sup> For example, corporations are required to hold annual meetings, during which shareholders are able to exercise their rights to vote on directors and other important matters.<sup>84</sup> However, most shareholders vote by proxy rather than by attending the meetings, so the voting procedure is governed by strict proxy rules.<sup>85</sup> The individual shareholder's ability to vote for directors is part of the control held by each shareholder<sup>86</sup> via the corporation's board of directors.<sup>87</sup> Rules governing proxy votes are generally viewed as a mechanism of protection for shareholder voting rights, but the rules have significant downfalls for shareholders.<sup>88</sup> The downfalls include increased costs, delays, and substantial legal risks, all of which ultimately discourage

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76. LEWIS S. BLACK, JR., *WHY CORPORATIONS CHOOSE DELAWARE* 1 (2007).

77. *Id.*

78. *Id.*

79. See Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 533 (1991).

80. *Id.* at 534.

81. *Id.*

82. *Id.*

83. *Id.* at 535.

84. *Id.*

85. Black, *supra* note 79, at 535.

86. *Id.*

87. See Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 430–31 (2006).

88. See Black, *supra* note 79, at 536; Stephen Choi, *Proxy Issue Proposals: Impact of the 1992 SEC Proxy Reforms*, 16 J.L. ECON. & ORG. 233, 265–66 (2000).

communication among shareholders.<sup>89</sup> These downfalls affect not only the average shareholders, but also the activists that set out to help them.

## 2. *The Sarbanes–Oxley Act and the Stock Exchange Rules*

Congress passed the Sarbanes–Oxley Act in 2002 in response to the scandals at Enron, WorldCom, and Tyco.<sup>90</sup> The enactment of SOX intended to enhance corporate governance while also restoring investors' confidence in corporate America.<sup>91</sup> It requires that a publicly held corporation must have a board of directors consisting of a majority of "independent" directors, that an audit committee must consist of all independent directors, and that there must be regular meetings held for only the independent directors.<sup>92</sup> The NYSE furthers the SOX standards by requiring that corporations must have corporate governance and compensation committees that consist entirely of independent directors.<sup>93</sup>

The SOX, NASDAQ, and NYSE rules, however, have not had a pronounced impact on the structure of corporate governance for American corporations.<sup>94</sup> The U.S. system is still deemed to be "regulator led," meaning the Securities Exchange Commission (SEC) and the stock exchanges are solely responsible for implementing and enforcing proper governance standards.<sup>95</sup> In the United States, the separation of ownership and management allows managers to run corporations, for the most part, freely.<sup>96</sup> While a corporation's board, composed of both executive and non-executive directors, has the power to oversee management, executives hold more power than non-executive directors.<sup>97</sup> This power can ultimately be detrimental to

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89. Black, *supra* note 79, at 536; *see infra* notes 175–93 and accompanying text.

90. Awan & Akhtar, *supra* note 72, at 59.

91. Julia Hanna, *The Costs and Benefits of Sarbanes–Oxley*, FORBES (Mar. 10, 2014, 11:15 AM), <http://www.forbes.com/sites/hbsworkingknowledge/2014/03/10/the-costs-and-benefits-of-sarbanes-oxley/#44d856362776>.

92. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended at 15 U.S.C. §§ 78a–78qq (2012)); Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1022–23 (2010).

93. *See* NYSE, LISTED COMPANY MANUAL §§ 303A.04–05, [http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp\\_1\\_4\\_3\\_3&manual=%2Fflcm%2Fsections%2Fflcm-sections%2F](http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp_1_4_3_3&manual=%2Fflcm%2Fsections%2Fflcm-sections%2F) (last visited Feb. 15, 2017); *see also* Kahan & Rock, *supra* note 92, at 1023.

94. Awan & Akhtar, *supra* note 72, at 60. *See generally* John C. Coates & Suraj Srinivasan, *SOX After Ten Years: A Multidisciplinary Review*, 28 ACCT. HORIZONS 627 (2014).

95. Ethiopis Tafara, Dir., Office of Int'l Affairs, SEC, Remarks on UK and US Approach to Corporate Governance and on the Market for Corporate Control (Feb. 8–9, 2007), <https://www.sec.gov/news/speech/2007/spch020807et.htm>.

96. *Corporate Governance*, *supra* note 75.

97. *Id.*

corporations as executives holding equity in the corporation may be more concerned about their own financial gains, and shareholders may not have enough control to remove these self-interested executives.<sup>98</sup> Similarly, the board's main role is to address conflicts of interest and self-dealing by management, but board members also have limited involvement in the daily management of corporations.<sup>99</sup> For that reason, a corporation's board of directors has a limited governance role.<sup>100</sup>

Bound by the structural limitations inherent to corporations, SOX has not reached its full potential.<sup>101</sup> State law—primarily Delaware's General Corporation Law and related common law—remains at the center of the corporate governance regime, which has proven to be unbeneficial to shareholders.<sup>102</sup> For example, between 2002 and 2012, only fifteen Delaware court decisions referred to SOX, and none of those decisions imposed punishments for the corporations that failed to follow the SOX standards.<sup>103</sup> Even with the implementation of SOX, the U.S. corporate governance system has not been greatly changed.

### 3. *Section 13(d) of the Securities Exchange Act*

The Williams Act<sup>104</sup> was enacted in 1968 as an amendment to the Securities Exchange Act of 1934 and as a mechanism of protection against the activist investors that were deemed to be “corporate raiders.”<sup>105</sup> As a result of the Williams Act, Section 13(d) of the Securities Exchange Act now requires mandatory disclosure of financial and other information for any person or group with five percent of beneficial ownership in a corporation.<sup>106</sup> “Beneficial ownership” is defined broadly and includes the power, sole or shared, to sell or direct the

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98. *Is Corporate Governance Better Across the Atlantic?*, VALUEWALK (Jan. 11, 2013, 12:55 PM), <http://www.valuewalk.com/2013/01/is-corporate-governance-better-across-the-atlantic/> (“[T]his absolute power [of the executives] has a tendency to corrupt or become arrogant. This sometimes makes executives work towards personal gains rather than shareholder interests.”). This problem is worsened by the fact that most shares are widely held and that shareholders are not involved in the day-to-day management of corporations. *Id.*

99. OWEN ET AL., *supra* note 71, at 91.

100. *Id.*

101. Coates & Srinivasan, *supra* note 94, at 12 (describing how Delaware courts rarely cite SOX and have never held a corporate director liable under the law).

102. *Id.* at 13.

103. *Id.* at 12.

104. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 455 (codified as amended at 15 U.S.C. §§ 78a–78u-2 (2012)).

105. Nagel et al., *supra* note 26, at 5.

106. Securities Exchange Act § 13(d)(1), 15 U.S.C. § 78m(d) (2012).

sale of securities and to vote or direct the voting of securities.<sup>107</sup> Under of this broad definition, shareholders and activist investors alike are wary of gaining ownership that exceeds the five percent threshold, because if the threshold is exceeded, they are subject to higher costs, potential lawsuits, and even invasions of privacy.<sup>108</sup> While American activists must follow these rules and regulations, the United Kingdom takes a very different approach. The next Section discusses the corporate governance system found across the pond.

#### D. Corporate Governance in the United Kingdom

While the U.S. corporate governance structure is comprised of federal statutes and state regulations,<sup>109</sup> the UK approach relies to a greater extent on “soft law” and self-regulatory mechanisms.<sup>110</sup> Opposite the “regulator led” U.S. approach, the UK corporate governance system is “shareholder led,” meaning shareholders have the power to determine what measures are necessary to protect their interests.<sup>111</sup> Under this system, there is not a strict enforcement of the rules and regulations as there is in the United States.<sup>112</sup> Instead, there is a “comply or explain” approach that allows deviation from the rules if necessary.<sup>113</sup> Parties must either comply with the UK codes or disclose their noncompliance with an explanation of the inability to com-

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107. Black, *supra* note 79, at 542–43.

108. *Id.* (“The company’s managers can and often will sue claiming misdisclosure of one sort or another, usually that the shareholder has concealed her true intent. Mere allegation of a concealed intent is usually enough to warrant court ordered discovery . . . the SEC or other shareholders can also seek profit disgorgement, and the cost of the suit must be borne win or lose.”).

109. This approach is characterized by one size fits all approach that is designed to address common governance problems. Ruth V. Aguilera et al., *Regulation and Comparative Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE GOVERNANCE 23, 38 (Mike Wright et al. eds., 2013).

110. Soft law is characterized by “comply-or-explain approaches” that allow corporations to choose the governance mechanisms that best fir their business model. *Id.*; see also Anita Indira Anand, *An Analysis of Enabling vs. Mandatory Corporate Governance Structures Post-Sarbanes-Oxley*, 31 DEL. J. CORP. L. 229–30 (2006).

111. Tafara, *supra* note 95.

112. *Id.*

113. FIN. REPORTING COUNCIL, THE UK APPROACH TO CORPORATE GOVERNANCE (2010), <https://www.frc.org.uk/getattachment/1db9539d-9176-4546-91ee-828b7fd087a8/The-UK-Approach-to-Corporate-Governance.aspx>; see *Corporate Governance*, *supra* note 75; see also NO-LAN HASKOVEC, MILLSTEIN CTR. FOR CORP. GOVERNANCE & PERFORMANCE, CODES OF CORPORATE GOVERNANCE: A REVIEW 1, 13 (2012), [http://web.law.columbia.edu/sites/default/files/microsites/millstein-center/Codes%20of%20Corporate%20Governance\\_Yale\\_053112.pdf](http://web.law.columbia.edu/sites/default/files/microsites/millstein-center/Codes%20of%20Corporate%20Governance_Yale_053112.pdf) (“The UK codes are not firm regulations, but a roster of principles-based guidelines, compliance with which is voluntary. If a company or institutional investor chooses not to follow one, it must state why.”).

ply.<sup>114</sup> This allows shareholders, other corporations, and the general public to understand each corporation's approach to governance.<sup>115</sup>

The shareholder-led, soft-law approach affects the way that European corporations are governed.<sup>116</sup> In Europe, the separation of ownership and management is not as clear as it is in the United States.<sup>117</sup> The board of a European corporation consists of a variety of people, ranging from majority shareholders to banks and lenders.<sup>118</sup> The European approach allows for less room for corruption of those in management positions because shareholders of European corporations are more involved in the day-to-day management of corporations than are shareholders of U.S. corporations.<sup>119</sup> These ideas are embodied in the UK Companies Act of 2006,<sup>120</sup> which requires the boards of corporations to focus on shareholder value.<sup>121</sup> To ensure that shareholder value is maximized, the Act provides shareholders with a number of tools that can assist them in engaging with a corporation and making their voices heard.<sup>122</sup> These tools consist of the shareholders' ability to call special meetings, to remove directors relatively easily, and to submit proposals that remain binding once passed.<sup>123</sup> UK corporations also absorb the costs of shareholder proposals, therefore encouraging more frequent proposals.<sup>124</sup> These are all tools that shareholders lack in the United States.<sup>125</sup>

114. UK STEWARDSHIP CODE 1, 4 (FIN. REPORTING COUNCIL 2012).

115. *Id.*

116. "The fundamental *legal* difference between the U.S. system of corporate governance and the Continental European corporate law system is the way they distribute powers within a corporation." Sofie Cools, *The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers*, 30 DEL. J. CORP. L. 697, 738 (2005).

117. *Id.*

118. See generally HASKOVEC, *supra* note 113.

119. "The government does not have a didactic approach because the board structure appears to have checks and balances which prevent Directors from taking decisions which may be to their own advantage." *Is Corporate Governance Better Across the Atlantic?*, *supra* note 98.

120. Companies Act 2006, c. 46 (Eng.), [http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga\\_20060046\\_en.pdf](http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf).

121. FIN. REPORTING COUNCIL, *THE UK APPROACH*, *supra* note 113, at 6.

122. Bonnie Buchanan & Tina Yang, *A Comparative Analysis of Shareholder Activism in the US and UK: Evidence from Shareholder Proposals* 1, 7 (Oct. 15, 2008) (unpublished manuscript), [http://www.researchgate.net/publication/228452719\\_A\\_comparative\\_analysis\\_of\\_shareholder\\_activism\\_in\\_the\\_US\\_and\\_UK\\_Evidence\\_from\\_shareholder\\_proposals](http://www.researchgate.net/publication/228452719_A_comparative_analysis_of_shareholder_activism_in_the_US_and_UK_Evidence_from_shareholder_proposals).

123. *Id.* at 7–8. Shareholders, holding ten percent or more ownership, have the ability to call a special meeting to propose and to vote on an amendment to the corporation's articles of association. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 848–49 (2005). Under section 303, shareholders can call a special meeting to replace all directors and then can do so at that meeting with a majority of votes. *Id.* at 849.

124. Buchanan & Yang, *supra* note 122, at 2–3.

125. Aguilera et al., *supra* note 109, at 28 ("[S]oft norms fill in voids for formal hard law and often become an important mechanism for innovation in the regulatory sphere.").

The UK Corporate Governance Codes concentrate mainly on the relationship between corporations and their shareholders.<sup>126</sup> By reaching for good governance practices and ultimately a successful relationship between the two parties, the Code aims for UK corporations to have long-term success.<sup>127</sup> In order to achieve this goal, the Code lays out a collection of standards of good practice that range from topics such as board leadership and effectiveness to board accountability and its relations with shareholders.<sup>128</sup> In addition to the UK Corporate Governance Code, the UK Stewardship Code is based on seven key principles for institutional investors.<sup>129</sup> The Stewardship Code focuses on the relationship between investors and companies to help increase returns to shareholders, and ensure the efficiency of governance systems.<sup>130</sup> The principles of the code are as follows:

So as to protect and enhance the value that accrues to the ultimate beneficiary, institution investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.<sup>131</sup>

Taken together, the UK Corporate Governance Code and the UK Stewardship Code allow shareholders to reap as many benefits as possible.<sup>132</sup> The Codes encourage discussion between investors and the boards of corporations in which shareholders seek to implement change.<sup>133</sup> When UK corporations decide to follow the Codes under the “comply or explain approach,” the boards engage with shareholders regularly and provide them with necessary information that is rele-

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126. UK CORP. GOVERNANCE CODE 3 (FIN. REPORTING COUNCIL 2014).

127. *Id.*

128. *Id.* at 9–10.

129. UK STEWARDSHIP CODE 5 (FIN. REPORTING COUNCIL 2012).

130. HASKOVEC, *supra* note 113, at 10.

131. UK STEWARDSHIP CODE 5 (FIN. REPORTING COUNCIL 2012).

132. “The UK Corporate Governance Code identifies the principles that underlie an effective board. The UK Stewardship Code sets out the principles of effective stewardship by investors. In doing so, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the ‘comply or explain’ system.” *Id.* at 1.

133. Jeffery Roberts et al., *Shareholder Activism in the U.K. – An Introduction*, WALL ST. LAW., May 2013, at 1, 7.



vant to their concerns.<sup>134</sup> Policies such as this have led to the successful operation of governance regimes within corporations in the United Kingdom, causing American activists to travel abroad to take advantage of the shareholder friendly system.<sup>135</sup>

### *E. The Migration of American Activists to Europe*

While speaking at the University of Oxford's Said Business School in October of 2013, activist shareholder William Ackman of Pershing Square Capital stated that shareholder activism in Europe was "going to happen."<sup>136</sup> One month later, Gilberto Pozzi, who heads the European mergers and acquisitions department at Goldman Sachs stated, "U.S. activists are likely to target European opportunities in the short to medium term."<sup>137</sup> Ackman and Pozzi were correct, as overcrowding in the United States' market, lower valuations, and most importantly, more shareholder friendly European laws, have increased the appeal of moving abroad.<sup>138</sup>

With the enactment of the UK Corporate Governance Code and the UK Stewardship Code, the United Kingdom has indeed become one of the most activist friendly markets in not only Europe, but in the world.<sup>139</sup> For that reason, the United Kingdom may be the most ideal setting for shareholder activism.<sup>140</sup> The diverse laws and rights in the United States and United Kingdom demonstrate how activists may have more influence abroad than in their home arena.<sup>141</sup> Two of the most significant differences stem from (1) the ability of UK shareholders with just 5% of stock ownership to request a shareholder

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134. *Id.*

135. OWEN ET AL., *supra* note 71, at 27–28 (2006) ("[T]he effectiveness of this system is driven by the UK ownership and institutional structure which gives greater influence over the board of directors to institutional investors than in either the US or Continental Europe.").

136. Chad Bray, *Ackman Sees Expansion of Activist Investing to Europe*, N.Y. TIMES: DEALBOOK (Oct. 29, 2013, 5:32 PM), [http://dealbook.nytimes.com/2013/10/29/ackman-sees-expansion-of-activist-investing-to-europe/?\\_r=0](http://dealbook.nytimes.com/2013/10/29/ackman-sees-expansion-of-activist-investing-to-europe/?_r=0).

137. Nathan Vardi, *American Activist Investors Get Ready to Invade Europe*, FORBES (Dec. 20, 2013, 8:34 AM), <http://www.forbes.com/sites/nathanvardi/2013/12/20/american-activist-investors-get-ready-to-invade-europe-2/>.

138. Flaherty & Cruise, *supra* note 10.

139. SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, *ACTIVIST INVESTING IN EUROPE: A SPECIAL REPORT 4* (2014), [http://www.skadden.com/newsletters/Activist\\_Investing\\_in\\_Europe\\_October\\_2014\\_Skadden\\_Special\\_Report.pdf](http://www.skadden.com/newsletters/Activist_Investing_in_Europe_October_2014_Skadden_Special_Report.pdf).

140. Marco Becht et. al., *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes U.K. Focus Fund*, 22 REV. FIN. STUD. 3093, 3095 (2009).

141. MACFARLANES LLP, *ACTIVISM: 10 KEY DIFFERENCES BETWEEN THE US AND THE UK* (2015), <http://www.macfarlanes.com/media/452974/activism-10-key-differences-between-the-us-and-the-ukv2.pdf> ("These statutory shareholder rights are extremely powerful weapons in the activist's arsenal.").

meeting, and (2) at that shareholder meeting, shareholders can remove directors with 50% of the vote, as opposed to the majority rule that is required in the United States.<sup>142</sup> The inability for corporations to use poison pills<sup>143</sup> as a method of protection against activists may also be a leading reason for the migration, as this prevents management from blocking takeover bids and leaves shareholders with the power to decide what to do when investors seek change.<sup>144</sup> Furthermore, annual general meetings in the United States make it difficult for activist investors to gain access to the board when corporations are not taking steps to maximize shareholder value.<sup>145</sup>

In favor of both the structure and substance of the UK corporate governance laws, shareholders are migrating abroad and taking with them the opportunity for the U.S. market to grow and flourish.<sup>146</sup> For example, San Francisco-based ValueAct Capital recently set its sights on British company and aerospace giant, Rolls Royce.<sup>147</sup> After doing so, ValueAct Capital acquired a 10.8% stake in Rolls Royce.<sup>148</sup> Even with such a large stake, Rolls-Royce “embraced ValueAct” and stated that there was no friction; the activists and the company were working together to turn the company around.<sup>149</sup> The collaboration has proven to be successful. Rolls-Royce has appointed Bradley Singer, a

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142. See SKADDEN, *supra* note 139, at 4; see also OWEN ET AL., *supra* note 71, at 3.

143. See Chase de Kay Wilson, *Marty Lipton's Poison Pill*, INT'L FIN. L. REV., May 1984, at 10–11. Poison Pills are strategies used by corporations to discourage hostile takeovers and protect shareholders. When a company decides that a bid for a takeover is not acceptable, it issues tax-free dividends to shareholders in the form of preferred stock, which converts into a larger number of common shares and creates an incentive for the shareholder to keep the stock and refuse a tender. See David Futrelle, *Corporate Raiders Beware: A Short History of the “Poison Pill” Takeover Defense*, TIME (Nov. 7, 2012), <http://business.time.com/2012/11/07/corporate-raiders-beware-a-short-history-of-the-poison-pill-takeover-defense/> (“Netflix’ [sic] poison pill is what’s known as a ‘flip-in’ plan, which offers shareholders the opportunity to buy discounted shares once a hostile shareholder has gobbled up a certain percentage of shares, usually 15%.”).

144. See Bebchuk et al., *The Long-Term Effects*, *supra* note 29, at 849; see also SKADDEN, *supra* note 139, at 4.

145. OWEN ET AL., *supra* note 71, at 15. For example, Berkshire Hathaway’s annual meeting is described as having a “day-long, carnival-like atmosphere” that includes comedy skits, music and dancing, and games. Lisa Smith, *A Peak into Shareholder Meetings*, INVESTOPEDIA, <http://www.investopedia.com/articles/investing/062413/peek-shareholder-meetings.asp> (last visited March 23, 2017). The business portion of the meeting only takes around 20 minutes and occurs in a “largely scripted manner.” *Id.* For this reason, “[w]hile individual investors may have opinions of various topics and are able to express those opinions by putting forth proposals, the biggest voting blocks are often the financial institutions, pension funds and similar entities that hold large stakes in the firms.” *Id.*

146. Flaherty & Cruise, *supra* note 10.

147. *Rolls-Royce Gives Board Seat to Activist Shareholder*, BBC (Mar. 2, 2016), <http://www.bbc.com/news/business-35704485>.

148. *Id.*

149. *Id.*

partner and chief operating officer of ValueAct Capital, to the board of directors in order to give ValueAct a bigger voice as they work together to improve the corporation.<sup>150</sup> Part III discusses the changes that could be made in the United States in order to prevent more activists from crossing the pond, as ValueAct has done.

### III. ANALYSIS

In 2015, activist shareholders targeted 131 companies outside of the United States, which is a 47% increase from the year before.<sup>151</sup> Activists prefer to target corporations in a country such as the United Kingdom, where the laws enable them to make their desired changes more easily.<sup>152</sup> This preference has already turned into action as American activists are targeting more corporations outside of the United States than ever before.<sup>153</sup> In 2016, the United Kingdom experienced a forty-six percent increase in activist campaigns over 2015 figures, which was the largest increase of any European country.<sup>154</sup> This figure will only continue to increase if the United States' corporate governance system is not reformed.

The United States should alter its corporate governance system to reflect the shareholder-friendly policies embodied in the United Kingdom's corporate governance laws. Current U.S. laws, primarily Section 13(d) of the Securities Exchange Act and the proxy regulation rules, do not allow activists to reach their full potential to create change in corporate America. In order to retain the American activist investors in the United States, the UK Stewardship Code's fifth and sixth principles and Section E.1 and E.2 of the UK Corporate Governance Code should be incorporated into the U.S. corporate governance system. This combined corporate governance system would convince

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150. *Activist Investor ValueAct Gets Its Rolls-Royce Board Seat*, FORTUNE (Mar. 2, 2016, 4:41 AM), <http://fortune.com/2016/03/02/rolls-royce-valueact-board-seat/>.

151. Flaherty & Cruise, *supra* note 10.

152. OWEN ET AL., *supra* note 71 at 57 ("In the UK, both public and private sector funds are more engaged in pragmatic investor activism as compared to the US, as they do not face the same conflicts of interests.").

153. Flaherty & Cruise, *supra* note 10; Juliet Samuel, *American Activist Investors Take Another Charge at Europe*, WALL ST. J. (Apr. 22, 2015, 4:08 PM), <http://www.wsj.com/articles/american-activist-investors-take-another-charge-at-europe-1429733285>; see also Billy Bambrough, *The Revolution Will Be Monetised: Activist Investors Are Closing in on a Record Year*, CITY A.M. (Nov. 5, 2015 12:02 AM), <http://www.cityam.com/228048/the-revolution-will-be-monetised-activist-investors-are-closing-in-on-a-record-year> ("So far this year, the UK has been a hotbed of investor activism, with 32 so called 'activist actions' more than any other European country.").

154. Chelsea Naso, *Shareholder Activism Catching Fire in Europe, Asia*, LAW360 (May 16, 2016, 2:44 PM), <http://www.law360.com/articles/796152/shareholder-activism-catching-fire-in-europe-asia>.

American activists to keep capital in the United States by allowing them to more easily enact changes in American corporations. This Part first describes the ways in which the activists are restricted in the United States and then details the portions of the UK law that would be beneficial for activist investors in their homeland. Part III concludes by identifying how the United States could operate under a merged corporate governance system combined of the favorable laws from both countries.

#### A. U.S. Corporate Governance Laws Are Holding Activists Back

Majority shareholders in the United States are given various legal rights.<sup>155</sup> These rights range from the right to vote and to inspect corporate books and records to the right to sell shares and receive dividend payments.<sup>156</sup> Mary L. Schapiro, Chairman of the SEC, discussed these rights in a speech given on December 15, 2011.<sup>157</sup> She stated,

Shareholders should have a voice and a straightforward and transparent process for engaging with companies on issues that are important to them. Shareholders and boards should have clear conversations about how the company is governed — and why and how decisions are made. As a general rule, interested, aware and active shareholders are good for public companies, and I believe that more shareholder engagement is better.<sup>158</sup>

The United States, however, has done little to ensure that shareholder engagement actually occurs.<sup>159</sup> The separation of ownership and management leads many managers to pursue goals that are not beneficial to shareholders. In order to remedy this, various laws have been passed in the United States that make many important corporate governance features the subject of mandatory regulation.<sup>160</sup> Conversely, instead of propelling activist shareholders forward, these laws are actually holding activists back.<sup>161</sup> In particular, Section 13(d) of the Securities Exchange Act and the rules that govern proxy regulation act

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155. Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 413 (2006).

156. FRED R. KAEN, A BLUEPRINT FOR CORPORATE GOVERNANCE: STRATEGY, ACCOUNTABILITY, AND THE PRESERVATION OF SHAREHOLDER VALUE 178 (2003).

157. Mary L. Schapiro, Chairman, SEC, Remarks at the Transatlantic Corporate Governance Dialogue (Dec. 15, 2011), <https://www.sec.gov/news/speech/2011/spch121511mls.htm>.

158. *Id.*

159. For example, the Sarbanes–Oxley Act has done nothing to change the basic structure of corporate governance in America. Awan & Akhtar, *supra* note 72, at 60.

160. See e.g., Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78qq (2012); Sarbanes–Oxley Act of 2002, 15 U.S.C. §§ 7201–7266 (2012); Dodd–Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. §§ 5301–5641 (2012).

161. “The current state of shareholder rights is the result of an unfortunate blend of competing regulations that undermine more fundamental aspects of corporate law and therefore would

as two of the least shareholder friendly policies in the United States.<sup>162</sup> As a result, shareholders are given little to no management rights and are very restricted in the ways they may communicate with board members, causing activists and the advantages they provide to migrate abroad.<sup>163</sup>

### 1. *Section 13(d) of the Securities Exchange Act*

Section 13(d) of the Securities Exchange Act is often cited as a reason for lower coordinated performance in the shareholder activism field.<sup>164</sup> While coordinated activism would allow all varieties of shareholders to work together to create greater change in American corporations, such a situation is rare.<sup>165</sup> The rarity of this form of activist intervention makes the push for even stricter disclosure rules alarming.<sup>166</sup> In March of 2011, Wachtell, Lipton, Rosen, & Katz sent a petition to the SEC to amend section 13(d) of the Securities Exchange Act.<sup>167</sup> In the petition, Wachtell requested that section 13(d) be amended to “shorten the reporting deadline and expand the definition of beneficial ownership under the reporting rules.”<sup>168</sup> Specifically, Wachtell first requested that the disclosure window be shortened from ten days to one day after gaining five percent ownership.<sup>169</sup> Wachtell also requested that the definition of “beneficial ownership” be expanded to include “ownership of any derivative instrument which includes the opportunity, directly or indirectly, to profit or share in any profit derived from any increase in the value of the subject security.”<sup>170</sup> In making these amendments, Wachtell argued that investors, as well as the market as a whole, would benefit.<sup>171</sup> In similar fashion,

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benefit from reform.” Julian Velasco, *Taking Shareholder Rights Seriously*, 41 U.C. DAVIS L. REV. 605, 610 (2007).

162. See generally Awan & Akhtar, *supra* note 72.

163. Velasco, *supra* note 155, at 407 (“The history of corporate law has been one of increasing flexibility for directors and decreasing rights for shareholders. Although the law seems to have coalesced around the norm of shareholder primacy, this is not necessarily reflected in the specific legal rights of the shareholder.”).

164. Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459, 461 (Peter Newman, ed., 1998).

165. *Id.* (“[E]ach institution acts as a lone wolf (though hoping for informal support from other institutions), and two institutions try *not* to target the same firm in the same year.”).

166. *Id.*

167. Wachtell, Lipton, Rosen & Katz, Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934 (Mar. 7, 2011), <https://www.sec.gov/rules/petitions/2011/petn4-624.pdf>.

168. *Id.* at 1.

169. *Id.* at 3, 5.

170. *Id.* at 8.

171. *Id.* at 1.

two Senators, Tammy Baldwin of Wisconsin and Jeff Merkley of Oregon, introduced the Brokaw Act in March 2016, in order to “rein in Wall Street.”<sup>172</sup> The justification for this new legislation was the belief that activist investors are leaders of only short-term changes in corporate America.<sup>173</sup> The bill would have reduced the ten-day disclosure period to two days, required the disclosure of holdings that currently do not have to be reported, and would have altered who has the duty to report in general after acquiring at least five percent of a corporation's shares.<sup>174</sup>

There are numerous problems with Wachtell's petition and the proposed Brokaw Act. Tightening the disclosure rules of section 13(d) would increase costs for shareholders.<sup>175</sup> Shareholders would likely lose money, both directly and indirectly, because activist campaigns are less likely to occur with stricter disclosure rules.<sup>176</sup> Directly, shareholders would not be able to benefit from the higher stock returns that are associated with activist campaigns.<sup>177</sup> Indirectly, the more restrictive disclosure rules would discourage activist investors from launching campaigns in the United States.<sup>178</sup> Because activists bear the costs of their campaigns, they will avoid situations in which the campaign benefits do not justify the costs.<sup>179</sup> An earlier disclosure period would increase the costs of acquiring stock in corporations and would increase administrative costs in complying with the SEC,

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172. Antoine Gara, *Bernie Sanders and Elizabeth Warren Back Useless Bill to Regulate Hedge Fund Activism*, FORBES (Mar. 17, 2016, 5:16 PM), <http://www.forbes.com/sites/antoinegara/2016/03/17/bernie-sanders-and-elizabeth-warren-back-useless-bill-to-regulate-hedge-fund-activism/#64ba5f968af0>.

173. *Id.*

174. See Claire Groden, *These Senators Want to Reign in Activist Investors*, FORTUNE (Mar. 18, 2016, 3:04 PM), <http://fortune.com/2016/03/18/democrats-shareholder-activism/>; Liz Moyer, *2 Senate Democrats Introduce Bill to Curb Activist Hedge Funds*, N.Y. TIMES, (Mar. 17, 2016), [http://www.nytimes.com/2016/03/18/business/dealbook/2-senate-democrats-introduce-bill-to-curb-activist-hedge-funds.html?\\_r=1](http://www.nytimes.com/2016/03/18/business/dealbook/2-senate-democrats-introduce-bill-to-curb-activist-hedge-funds.html?_r=1).

175. Lucian A. Bebchuk et al., *Pre-Disclosure Accumulations By Activist Investors: Evidence & Policy*, 39 J. CORP. L. 1, 18 (2013) (“These costs arise from the simple fact that requiring activist investors to disclose their ownership in public companies more quickly will reduce these investors' returns—thereby reducing the incidence and magnitude of outside blockholdings in large public companies.”).

176. *Id.* at 19.

177. *Id.*; see Jason W. Soncini, *The Brokaw Act's Long-Term Consequences for Activists*, LAW360 (Apr. 15, 2016, 10:29 AM), <http://www.law360.com/articles/784189/the-brokaw-act-s-long-term-consequences-for-activists> (“[T]he focus on the elimination of short-termism via the elimination of activism seems misguided. Those who decry activists ignore the positive, long-term role activists play in the economy and the profound risk of increased management entrenchment if Congress hobbles the activist community.”).

178. Bebchuk et al., *Pre-Disclosure Accumulations*, *supra* note 175, at 18.

179. Soncini, *supra* note 177.

thereby reducing returns.<sup>180</sup> With costs likely outweighing the benefits, the disclosure period would trigger an adverse effect of lowering the activists' incentive to launch campaigns in the first place.<sup>181</sup> With less activist campaigns, shareholders would likely lose money, as they would not be able to benefit from the activist campaigns that decrease managerial problems and increase shareholder value.<sup>182</sup> The SEC must examine the benefits of activist shareholder campaigns before making any decisions regarding the petition and proposed legislation.<sup>183</sup> If the fundamental changes of either proposal ever pass, they will surely provide even more encouragement for the activists to move abroad to find companies, and their jurisdiction's laws, that are better suited for their investments.

Activists also benefit other shareholders by increasing the possibility of a proxy fight, which plays a large role in ensuring that directors remain accountable for a corporation's performance.<sup>184</sup> Activist companies have the capital to bear the costs involved in a proxy challenge, whereas shareholders with a lower amount of shares generally do not have the money to do so.<sup>185</sup> Without activist intervention, "incumbent directors and executives face a substantially reduced threat of a proxy fight in case of underperformance, and this insulation from the possibility of a proxy fight will be likely to have an adverse effect on shareholder interests, increasing agency costs, and managerial slack."<sup>186</sup> The U.S. law puts these activists at a "greater disadvantage than they face in other relevant jurisdictions."<sup>187</sup> In fact, the United States is the only common law country where an "outside blockholder disclosing its presence [must] fear being immediately subject to a poison pill"<sup>188</sup>

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180. *Id.*

181. Bebchuk et al., *The Long-Term Effects*, *supra* note 29, at 18–19.

182. *Id.* at 19.

183. See Lucian A. Bebchuk & Robert J. Jackson, Jr., *The Law and Economics of Blockholder Disclosure*, 2 HARV. BUS. L. REV. 39, 51 (2012).

"Before tightening the rules governing the outside investors who hold large blocks of public company stock, regulators should carefully consider the valuable role that these outside blockholders play in corporate governance, the increased agency costs and managerial slack that would arise if outside blockholders are discouraged or suppressed, and the significant empirical evidence on the benefits produced by outside blockholders. These considerations should play a role in the Commission's examination of the rules governing outside blockholders."

*Id.*

184. *Id.* at 49.

185. *Id.*

186. *Id.*

187. *Id.* at 57.

188. Bebchuk & Jackson, *supra* note 183, at 58; see *supra* note 143 and accompanying text (discussing poison pills).

that limits the ability of activists to gain ownership in a corporation.<sup>189</sup> A Delaware court, for example, recently held that a board could use a poison pill to block a fair and reasonable tender offer, essentially preventing shareholders from making their own decisions about tendering their shares.<sup>190</sup> Even though the shareholders were willing to accept the offer, the court found that state law gave the board of directors the power to make decisions for the shareholders.<sup>191</sup> This holding demonstrated that under current law, the only way shareholders can have a say in the corporation is through the board of directors, and that is not always sufficient.<sup>192</sup> This problem not only plays a role in corporate governance, but also puts the U.S. market at a disadvantage.<sup>193</sup> For that reason, the United States should adopt the shareholder friendly principles found in the United Kingdom so activists will remain in the United States, thus strengthening our market.

## 2. Proxy Regulation Rules

Proxy Rules require that those who solicit proxies must give a written statement with various disclosures to the SEC at least ten days before the proxy distribution mailing date so that the SEC can object to any statements.<sup>194</sup> This preclearance mechanism is not only expensive for shareholders, but it often delays their efforts.<sup>195</sup> This is especially true when shareholder statements discuss director election campaigns and oppositions to management proposals.<sup>196</sup> In these situations, within a small time period between the date of the company proxy statement and the date of the shareholder meeting, a shareholder must make a decision regarding the proposal, prepare and clear the proxy materials with the SEC, distribute the proxy materials, and get votes back.<sup>197</sup> This problematic issue is best explained by an analogy:

[I]magine a political campaign where each contestant, and each newspaper commenting on the campaign, had to state a long list of prescribed facts, including all 'material' facts, avoid misleading anyone, correct any prior statements which were no longer accurate,

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189. Steven Davidoff Solomon, *Poison Pill's Relevance in the Age of Shareholder Activism*, N.Y. TIMES: DEALBOOK (Apr. 18, 2014, 2:31 PM), <http://dealbook.nytimes.com/2014/04/18/poison-pills-relevance-in-the-age-of-shareholder-activism/>.

190. *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 108–11 (Del. Ch. 2011).

191. *Id.* at 129.

192. *See id.*

193. Bebachuk & Jackson, *supra* note 183, at 58.

194. Black, *supra* note 79, at 537–38.

195. *Id.* at 538–39.

196. *Id.* at 539–40.

197. *Id.* at 539.



and pre-clear everything with a government agency, in an environment where the central concept of materiality has only the vaguest of definitions and incumbent officials can use public funds to sue their opponents claiming failure to do any of the above, with no requirement that they show any concrete harm.<sup>198</sup>

Although it would be nearly impossible for all politicians and political reporters alike to take such extreme measures, that is exactly what is expected of shareholders. While attempting to make large decisions and enact change, shareholders must work quickly and without error to ensure that they are complying with the governing rules.<sup>199</sup> This creates a large obstruction in the means of accomplishing their goals.

Directly related to the ability to vote for directors is the ability, or rather inability, for shareholders to nominate directors.<sup>200</sup> In order to nominate directors, shareholders must submit proposals under Rule 14a-8 of the Securities Exchange Commission, which limits the shareholders' supporting proxy statement to 500 words.<sup>201</sup> The proposal must be submitted six months before the date of the shareholder meeting, and it is also limited in scope.<sup>202</sup> The scope of the proposal is limited in two specific ways: The proposal cannot be used to nominate candidates for the board of directors—one of the most important issues to shareholders—<sup>203</sup> and the proposal may not make statements in opposition to management proposals or for alternatives to management proposals.<sup>204</sup> While shareholders are clearly limited in their proxy statement proposals, a corporation's management can oppose statements without word limit restriction, can note the opposition on the proxy card in bold print, and can spend corporate funds to solicit votes against proposals they are against.<sup>205</sup>

A study conducted on thousands of corporations active between 1996 and 2002 found that there was an average of only seven challenges to directors per year.<sup>206</sup> These challenges have proven to be even more difficult when corporations have "staggered boards," in which only one-third of the board's total number of directors are

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198. Black, *supra* note 79, at 539–40.

199. *Id.*

200. *Id.* at 539.

201. 17 C.F.R. 240.14a-8 (2016).

202. Black, *supra* note 79, at 541.

203. *Id.* at 541–42.

204. *Id.* at 540.

205. See Bebachuk, *The Case for Increasing Shareholder Power*, *supra* note 123, at 856.

206. Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43, 44–46 (2003).

elected each year.<sup>207</sup> When corporations are set up in such a way, shareholders must win, at a minimum, two consecutive proxy fights in order to gain board control.<sup>208</sup> After examining the hardships that shareholders must face while attempting to have their voices heard, it is no surprise that many shareholders adopt the “Wall Street Rule.”<sup>209</sup> This rule subscribes to the idea that it is easier to switch than fight, meaning that shareholders may choose to simply invest in a new company rather than fight for changes in the current company in which they have invested.<sup>210</sup>

As many activist shareholders seek to change the management aspects in corporations, it is clearly problematic that shareholders are often willing to give up rather than to fight for their legal rights in the corporations in which they own stock.<sup>211</sup> For example, when shareholders decide to waive the “‘white flag’ in the battlefield of corporate governance,” shareholders exit the corporation while the board continues to manage the company in whatever manner it desires.<sup>212</sup> While selling the shares is a short-term solution to rid a shareholder of a bad corporate governance regime inside of the corporation, “the cumulative effect of such acts may also profoundly impact the quality of our products and environment, the treatment of employees, our balance of payments, and the well being of society-at-large.”<sup>213</sup> U.S. laws should encourage shareholders to enact changes in corporations rather than encouraging them to abandon the corporation, thereby creating numerous negative side effects for all of corporate America. In order to create an encouraging environment, aspects of the UK and

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207. George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 146 (2010).

208. *Id.*

209. Stephen M. Bainbridge, *Redirecting State Takeover Laws a Proxy Contests*, 1992 WIS. L. REV. 1071, 1080 (1992).

210. *Id.* (“To the extent the shareholders are satisfied, they will vote for management. Disgruntled shareholders, in contrast, will have long since sold out. As a result, shareholders are likely to vote for management even where that is not the decision an informed shareholder would reach.”).

211. In 2013, “the most popular activist strategy was seeking board representation, followed by the removal of a CEO or director, according to data from Activist Insight, which tracks the industry.” Jeff Green & Beth Jinks, *Activists Step Up to Revamp C Suite at Microsoft to J.C. Penney*, BLOOMBERG (Aug. 25, 2013, 11:01 PM), <http://www.bloomberg.com/news/articles/2013-08-26/activists-step-up-to-revamp-c-suite-at-microsoft-to-j-c-penney>.

212. Brandon Chen, Board Monitoring and the Wall Street Rule 2 (Sept. 20, 2010) (unpublished manuscript), <http://ssrn.com/abstract=1659436>; see *Ending the Wall Street Walk: Why Corporate Governance Now?* (1996), CORP. GOVERNANCE, <http://www.corpgov.net/library/papers-references/ending-the-wall-street-walk-why-corporate-governance-now/> (last visited Aug. 24, 2016) (“The reality is that if you don’t like the way the management handles your business, you have traditionally had two choices: hold your nose or sell out.”).

213. *Ending the Wall Street Walk*, *supra* note 212.

the U.S. corporate governance systems should be merged in order to create a governance regime that allows for all shareholders, including activists, to fight and implement necessary changes.

*B. How to Keep Our Investors in The Homeland*

In the post-Sarbanes–Oxley world, it seems likely that any reform that takes place in the United States will entail even more rules and regulations.<sup>214</sup> However, the addition of stricter rules and the tightening of the rules already in place will only continue to push activist investors out.<sup>215</sup> Instead, some form of compromise needs to be reached in order to keep the domestic activists in the United States. This Comment argues that the United Kingdom is the most ideal country from which to model a corporate governance reform. In the UK, it is agreed upon that “shareholders are the company.”<sup>216</sup> As a result, shareholders in UK companies are granted more powers in relation to governance and participation than compared to their U.S. counterparts.<sup>217</sup> This allows normal UK shareholders, as well as activist shareholders, to have a greater chance at enacting changes in the corporations in which they invest.<sup>218</sup>

According to the Financial Reporting Council (FRC), the intended beneficiaries of corporate governance laws are the shareholders, and they should decide whether or not a corporation’s governance practices are effective and allow the corporation to succeed.<sup>219</sup> In order for shareholders to decide what is best for a corporation in the long-term, the FRC notes that they must be well-informed and engaged investors.<sup>220</sup> For that reason, the FRC acts as a regulator to ensure that shareholders have all of the necessary information to properly assess the corporate governance tactics within corporations.<sup>221</sup>

The FRC enacted the UK Stewardship Code and the UK Corporate Governance Code to properly regulate shareholders and corporations.<sup>222</sup> According to the UK Stewardship Code, investors should aim to promote the long-term success of corporations so that corpora-

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214. OWEN ET AL., *supra* note 71, at 28.

215. *See generally* Flaherty & Cruise, *supra* note 10.

216. OWEN ET AL., *supra* note 71, at 29.

217. Iris H-Y Chiu, *Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK*, 38 DEL. J. CORP. L. 983, 994 (2014).

218. *Id.*

219. FIN. REPORTING COUNCIL, THE UK APPROACH, *supra* note 113, at 7.

220. *Id.*

221. *Id.*

222. *See generally* FIN. REPORTING COUNCIL, THE UK APPROACH, *supra* note 113.

tions, shareholders, and the economy as a whole benefit.<sup>223</sup> The Stewardship Code thus lays out good practice principles for investors to follow.<sup>224</sup> In similar fashion, the UK Corporate Governance Code lays out a set of governance standards that corporations should follow.<sup>225</sup> These standards ensure shareholder protection.<sup>226</sup> Although the Codes operate on the “comply or explain” basis,<sup>227</sup> a majority of corporations comply with the standards set forth in the Codes, proving that the soft-law-enabling approach of the United Kingdom is successful.<sup>228</sup> The success of the “comply or explain” model has provoked some to argue that the United States can and should learn from the UK approach.<sup>229</sup>

While all of the standards set forth in the Codes are respectable, it would be nearly impossible, and also unhelpful, to apply the Codes in their entirety to the American legal system.<sup>230</sup> This, in part, is because the United States and the United Kingdom have different markets.<sup>231</sup> The UK laws were designed to allow sophisticated and mobile investors to navigate the laws themselves.<sup>232</sup> The U.S. laws, on the other hand, were designed for less sophisticated investors so that government authorities could enforce the laws on behalf of the investors.<sup>233</sup>

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223. UK STEWARDSHIP CODE 1 (FIN. REPORTING COUNCIL 2012).

224. *Id.* at 5.

225. UK CORP. GOVERNANCE CODE 2 (FIN. REPORTING COUNCIL 2014).

226. *Id.* at 3.

227. See *infra* note 113 and accompanying text.

228. *Corporate Governance and Stewardship*, FIN. REPORTING COUNCIL, <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance.aspx> (last visited Aug. 24, 2016). See generally BLACKROCK, STATEMENT ON COMPLIANCE WITH THE UK STEWARDSHIP CODE (2012), [http://www.gla.ac.uk/media/media\\_278029\\_en.pdf](http://www.gla.ac.uk/media/media_278029_en.pdf); CHESHIRE PENSION FUND, UK STEWARDSHIP CODE—COMPLIANCE STATEMENT (2011), <http://www.cheshirepensionfund.org/wp-content/uploads/2013/02/UK-Stewardship-Code-2011-Compliance-Statement.pdf>; INFRA RED CAPITAL PARTNERS, UK STEWARDSHIP CODE DISCLOSURE STATEMENT (2015), <http://irpcp.com/files/Downloads/UK%20Stewardship%20Code%20Disclosure%20Statement.pdf>.

229. Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997, 2086 (1994) (“[T]he British experience suggests two lessons for the United States: (i) Reduce regulatory controls and institutional investors will become more active; and (ii) reduce regulatory controls and other constraints will surface that preclude radical change.”).

230. Tafara, *supra* note 95.

231. *Id.*

232. *Id.*

233. In her speech, Tafara analogized the U.S. market to a public roadway and the UK market to an F1 circuit. *Id.* He gave the analogy that on a public roadway, regardless of if you are a speed racer or a little old woman, the speed limit is always going to be 55 miles per hour. In an F1 circuit, however, the speeds range at a much higher limit. Just as an average U.S. motorist would not succeed in a Formula 1 race against an experienced racecar driver, the strict U.S. laws would not succeed in the U.K. *Id.* Similarly, just as a racecar driver that is used to speeds of 190 miles per hour would not succeed at driving at a much lower speed limit along public roads, the flexible U.K. laws would not succeed in the United States. *Id.*

Additionally, if the entire UK corporate governance system was adopted in the United States, it could potentially give shareholders too much power, and thus take away the need for activist shareholders.<sup>234</sup> For that reason, this Comment proposes a compromise: The United States should apply portions of the UK laws to its governance system. Specifically, Principle 5 and 6 of the UK Stewardship Code, as well as Section E of the UK Corporate Governance Code, should be implemented in the United States. Doing so would allow activists to remain in the United States and would allow them to generate their desired changes that benefit shareholders and corporations alike.

### 1. *The UK Codes To Be Followed in the United States*

The UK Stewardship Code and the UK Corporate Governance Code aim to ensure that shareholder protectionism methods are always present.<sup>235</sup> Therefore, certain parts of the Codes would be beneficial in the United States in order to ensure that shareholders, activists, and corporations can all work together for the greater good of each party.

First, the UK Stewardship Code's fifth principle, along with Section E.1 of the UK Corporate Governance Code, would be beneficial for both activists and general shareholders, as it would promote collaboration among all interested parties. Principle 5 states, "Institutional investors should be willing to act collectively with other investors where appropriate."<sup>236</sup> As guidance, the Code provides that investors should all communicate and work together in order to achieve their objectives.<sup>237</sup> Section E.1 states, "There should be a dialogue with shareholders based on the mutual understanding of objectives" and "[t]he board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place."<sup>238</sup> Under this section, directors are encouraged to attend meetings with shareholders in order to understand all of the issues and concerns that are of importance

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234. Samuel, *supra* note 153. ("Some investors say activism hasn't previously taken off in Europe partly because laws in some European countries give shareholders a bigger voice than they would have in the U.S., making activism less necessary.").

235. See UK STEWARDSHIP CODE 5-6 (FIN. REPORTING COUNCIL 2012); see also FIN. REPORTING COUNCIL, THE UK APPROACH, *supra* note 113, at 6-8.

236. UK STEWARDSHIP CODE 8 (FIN. REPORTING COUNCIL 2012); see also Konstantinos Sergakis, *The UK Stewardship Code: Bridging the Gap Between Companies and Institutional Investors*, 47 R.J.T. N.S. 109, 130 (2013) ("The scope of this principle is not just to extract information about how the strategy of an investor group can be shaped along with that of another group, but also to encourage interconnectivity between the same pools of investors in a wider context, since they will ultimately all be affected by the company's progression.").

237. Sergakis, *supra* note 236, at 119.

238. UK CORP. GOVERNANCE CODE 22 (FIN. REPORTING COUNCIL 2014).

to the shareholders.<sup>239</sup> Even before shareholders become “beneficial owners” of a corporation, boards often meet with shareholders to discuss their interests.<sup>240</sup> Although not legally necessary, this shows how UK corporations are willing to work with shareholders in order to hear their concerns and maximize their value.<sup>241</sup> The teamwork between UK corporations and their shareholders varies greatly from the relationship, or lack thereof, between American corporations and their shareholders, as previously discussed.<sup>242</sup> By incorporating these ideas in the U.S. governance regime, shareholders and the corporations could be seen as teammates, rather than, at times, enemies.

Second, the sixth principle of the UK Stewardship Code and Section E.2 of the UK Corporate Governance Code would also provide substantial benefits for activists, and therefore all shareholders, by continuing to promote unity between parties.<sup>243</sup> The sixth principle states, “Institutional investors should have a clear policy on voting and disclosure of voting activity.”<sup>244</sup> More importantly, this rule specifies that investors should not automatically support the board of a corporation in which it owns shares.<sup>245</sup> Section E.2 states that “the board should use general meetings to communicate with investors and to encourage their participation.”<sup>246</sup> Under this section, when resolutions are proposed, shareholders may vote either for or against the resolution via proxy forms.<sup>247</sup>

While U.S. shareholders must rely entirely on the board of a corporation for the protection of their benefits, UK boards work as delegates or agents of the shareholders.<sup>248</sup> Considering that board members owe fiduciary duties to the corporation itself, instead of the shareholders, the benefits of U.S. shareholders are not always adequately protected.<sup>249</sup> Conversely, board members in the UK owe their fiduciary duties to the corporation’s shareholders, therefore ensuring adequate shareholder protection.<sup>250</sup> The benefits of these laws can be seen in the takeover talks between Pfizer and the UK’s As-

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239. *Id.*

240. Roberts et al., *supra* note 133.

241. *Id.*

242. See *supra* notes 71–135 and accompanying text.

243. UK STEWARDSHIP CODE 5 (FIN. REPORTING COUNCIL 2012).

244. *Id.* at 9.

245. *Id.*

246. UK CORP. GOVERNANCE CODE 22 (FIN. REPORTING COUNCIL 2014).

247. *Id.*

248. OWEN ET AL., *supra* note 71, at 26.

249. *Id.* at 29.

250. *Id.*

traZeneca.<sup>251</sup> The decision of whether the takeover would take place or not was left in the hands of the board.<sup>252</sup> However, because of the UK Codes, this decision was actually in the hands of the shareholders.<sup>253</sup> For that reason, the takeover did not occur because the shareholders felt uneasy about the payments they would receive from their holdings of shares in the combined corporation.<sup>254</sup> The denial of this takeover by the AstraZeneca's shareholders exemplifies the role the Code plays in the day-to-day business of UK corporations, as well as the power that the shareholders hold.<sup>255</sup>

These provisions of the UK Codes give UK shareholders more power than U.S. shareholders. It is easier for activists in the UK to not only have their voices heard, but also to get their own candidates to become members of the board.<sup>256</sup> This allows UK activists to use a less hostile approach than is used by activists in the United States.<sup>257</sup> The activists do not "start a relationship with a lecture" or look for proxy fights; instead, the activists use a friendlier approach, in which they present their ideas with "solid arguments and solid facts."<sup>258</sup> They are able to work openly and patiently with shareholders in order to gain their support.<sup>259</sup> Therefore, instead of using the "Wall Street Rule" that is used by many American shareholders, UK shareholders are able to simply speak with board members when they do not like what the corporation is doing.<sup>260</sup> To illustrate, when activists send let-

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251. Roger Barker, *Pfizer's Pitch for AstraZeneca Reveals British Protectionism in a Global World*, CNN (May 13, 2014, 6:27 AM), <http://www.cnn.com/2014/05/13/business/pfizer-astrazeneca-roger-barker/>.

252. *Id.* (describing how the board is made up of shareholders).

253. Under the Code, "directors are explicitly required to deliver success over the long-term." *Id.*

254. *Id.*; see also Ben Hirschler & Bill Berkrot, *Pfizer Walks Away from \$118 Billion AstraZeneca Takeover Fight*, REUTERS (May 26, 2014 11:55 AM), <http://www.reuters.com/article/2014/05/26/us-astrazeneca-pfizer-idUSBREA3R0H520140526#pUSVPR7oqkzZc8Kl.97> ("Black-Rock, AstraZeneca's biggest shareholder, backed the board's rejection of Pfizer's 55 pounds a share offer.").

255. Tafara, *supra* note 95 ("Although the board may have a comparative advantage in making ordinary business decisions, the board has no advantage over the shareholders when it comes to deciding whether or not to sell the company to a bidder. That decision is simply a variation of the decision whether to buy or sell shares in the first place.").

256. Jen Wieczner, *Meet Europe's Best Activist Investor: Cevian's Christer Gardell*, FORTUNE (Aug. 27, 2015, 11:00 AM), <http://fortune.com/2015/08/27/christer-gardell-activist-investor-europe/>.

257. *Id.*

258. *Id.*; see also Samuel, *supra* note 153. According to Steven Brown, the chief executive of GO Investment Partners, "In Europe, you don't have to shout to get anywhere . . . . We approach companies and boards privately with a view to changing strategy." *Id.*

259. *Activism: 10 Key Differences*, *supra* note 141.

260. Alison Smith, *Activist Investors Can Find the UK a Tricky Destination*, FIN. TIMES (Dec. 18, 2013, 7:59 PM), <http://www.ft.com/intl/cms/s/0/96fd7292-67fb-11e3-8ada-00144feabdc0.html#>

ters to corporations in an attempt to discuss possible changes, UK corporations will generally answer the letters and seek the activists' opinions.<sup>261</sup> U.S. corporations, on the other hand, are much less responsive.<sup>262</sup> Activists abroad "have no problem at all in meeting management or chairmen or non-executive directors of any listed company in the UK."<sup>263</sup> Meanwhile, due to its lack of shareholder-friendly laws, the U.S. continues to be one of the most difficult environments to work in.<sup>264</sup> The positive UK results, however, could be mimicked for U.S. investors if the applicable sections of the UK Codes were to be implemented in the United States. The following Sections discuss how this could be done.

## 2. *A Merged Governance System*

The current corporate governance law in the United States stands out among the governance systems of other countries because of its restrictions on shareholders.<sup>265</sup> Not all people, however, see this as a bad thing. For example, Jack Welch, the former chief executive officer of General Electric, believes that "shareholder value is the dumbest idea in the world."<sup>266</sup> From his position, corporations need to stop focusing on shareholder value, and begin focusing on other aspects of the corporation, such as creating jobs, building factories, and producing a good work product.<sup>267</sup> However, this viewpoint overlooks the fact that when corporations place an emphasis on shareholder value, corporations function better overall.<sup>268</sup> Unfortunately, shareholder

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axzz3sjHmd9s9; see also Jonathan Marino & Matt Turner, *Activist Investors Keep Colliding – And It's Forcing the Industry to Transform*, BUS. INSIDER (Sep. 12, 2015, 12:55 AM), <http://www.businessinsider.com/wall-streets-activist-investors-are-heading-overseas-2015-9> ("Activists are much more likely to operate behind the scenes outside the US, exhorting company management to change strategy in private.").

261. Gretchen Morgenson, *Belated Apologies in Proxy Land*, N.Y. TIMES (Aug. 20, 2006), [http://www.nytimes.com/2006/08/20/business/yourmoney/20gret.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2006/08/20/business/yourmoney/20gret.html?pagewanted=all&_r=0).

262. *Id.*

263. BOB WEARING & YUVAL MILLO, CTR. BUS. PERFORMANCE, ACTIVIST INVESTORS IN UK QUOTED COMPANIES AND THE IMPLICATIONS FOR CORPORATE GOVERNANCE 21 (2011), <https://www.icaew.com/-/media/corporate/files/technical/corporate%20governance/uk%20corporate%20governance/tecpln10783%20activist%20investor%20report%20final%20reduced.ashx>.

264. Morgenson, *supra* note 261.

265. Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 123, at 848.

266. Francesco Guerera, *Welch Denounces Corporate Obsessions*, FIN. TIMES (Mar. 13, 2009, 2:00 AM), <http://www.ft.com/cms/s/0/3ca8ec2e-0f70-11de-ba10-0000779fd2ac.html#axzz4FuNnxHht>.

267. Andre Spicer, *Why Shareholder Value Is the 'Dumbest Idea in the World'*, CNN (Jan. 24, 2014, 6:36 AM), <http://www.cnn.com/2014/01/24/business/davos-shareholder-value-is-dumbest-idea/index.html>.

268. See Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV., July-Aug. 2012, at 48, 50.



value continues to be overlooked.<sup>269</sup> This is due, in part, to shareholders having minimal decision-making powers and corporate managers focusing on their own profits instead of shareholder value, in addition to the waves of scandal that seemingly plague corporate America.<sup>270</sup> Therefore, outside investors, such as activist shareholders, are needed to ensure the proper functioning of American corporations.<sup>271</sup> In fact, when investors such as activist shareholders hold more than five percent of outstanding shares in a corporation, the corporation is better governed, the executive pay is more reasonable, and the corporation as a whole outperforms its competitors.<sup>272</sup>

For that reason, the United States should adopt a “hybrid governance regime” that will give shareholders a greater voice.<sup>273</sup> According to Anita Anand, “[A]n enabling governance regime coupled with mandatory disclosure of a firm’s governance practices is likely to yield a high level of compliance at lower costs than a wholly mandatory regime.”<sup>274</sup> By retaining the mandatory disclosure laws that are already in place in the U.S., investors will have the information that they feel is necessary for them to make accurate investment decisions.<sup>275</sup> The “comply or explain” provisions of the UK Codes would work alongside these rules to accommodate and promote innovative shareholder ideas as shareholders and all sectors of the corporation would be operating together to maximize value.<sup>276</sup>

The changes that activist investors make promote more effective governance inside of the corporation, which in turn leads to the enhancement of shareholder value.<sup>277</sup> It is a domino effect that is trig-

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269. *Id.*

270. *Id.*

271. *Id.* at 56.

272. *Id.* at 55.

273. Anand, *supra* note 110, at 232.

274. *Id.* at 230.

275. *Id.* at 248–49 (“The disclosure enables investors to react to governance choices on the basis of full information.”).

276. INST. OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES, WHEN IS COMPLY OR EXPLAIN THE RIGHT APPROACH?, <http://www.icaew.com/-/media/corporate/files/technical/corporate-governance/dialogue-in-corporate-governance/icaew-tl-q3-web.ashx?la=en> (“This is particularly important in a complex area like corporate governance: it is about human behaviour, interaction and decision making which are most effective when companies act out of their own will, rather than being forced to change through structures and procedures.”).

277. Lisa M. Fairfax, *Shareholder Democracy on Trial: International Perspective on the Effectiveness of Increased Shareholder Power*, 3 VA. L. & BUS. REV. 1, 3 (2008) (“Professor Lucian Bebchuk notably argues that increasing shareholder democracy would improve corporate governance and enhance managerial accountability. Indeed, Bebchuk and others contend that augmenting shareholder power will make directors and officers more accountable to shareholders, thereby curbing abuses of authority and the incidence of misconduct. In Bebchuk’s view, in-

gered by the activists.<sup>278</sup> However, if U.S. activists do not have the adequate tools to make these essential changes, the dominos cannot fall into their rightful place and shareholders will not be able to maximize their profits.<sup>279</sup> UK shareholders are given the authority to decide what corporate governance measures are necessary and what is appropriate to protect their interests, so they have a better chance of seeing the changes that they want.<sup>280</sup> This idea should be incorporated in the United States.

### C. *But How Can a Merged Governance System Be Imposed?*

The convergence of various international corporate governance systems has been the subject of debate over the last decade, making the possibility of a U.S. and UK merged governance system a true possibility.<sup>281</sup> Opponents of conversion argue that governance systems and corporations' objectives "tend to reflect the institutional and historical differences in legal, political, social and cultural systems."<sup>282</sup> While this is true, the divergence of cultures is not problematic in this case, as the U.S. and UK are very similar in many respects. In fact, the UK and the U.S. are deemed to have a "special relationship" due to their similar political, diplomatic, cultural, economic, and historical relations.<sup>283</sup> However, the markets of the two countries are different.<sup>284</sup> This is why the entirety of the UK governance system cannot override the current U.S. corporate governance system. While this is true, there is no reason that small portions of the UK Codes cannot be merged with U.S. law to create the best possible arrangement for activist shareholders.

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creased shareholder democracy should translate into improved shareholder value." (footnotes omitted)).

278. *Id.*

279. James McConvill, *How Large Companies Can Make Shareholders Happy*, AGE (Dec. 22, 2005), <http://www.theage.com.au/news/business/how-large-companies-can-make-shareholders-happy/2005/12/21/1135032080136.html> ("[P]roponents of shareholder empowerment view shareholder governance rights as being a means to an end, rather than an end in itself. The 'end' which connects both proponents and opponents in their analysis is maximizing company performance—making the company as healthy as possible in governance terms to achieve more profits.").

280. See FIN. REPORTING COUNCIL, *THE UK APPROACH*, supra note 113, at 3; see also UK CORP. GOVERNANCE CODE 4 (FIN. REPORTING COUNCIL 2014).

281. Brian Ikol Adungo, *An Analysis of the View that the Corporate Governance Systems Worldwide Are Inevitably Converging Towards a Model Based on Shareholder Primacy and Dispersed Ownership Structure* § 1 (May 2, 2012) (unpublished manuscript), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2049764](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2049764).

282. *Id.* § 4.

283. See Winston Churchill, *Iron Curtain Speech at Westminster College* (Mar. 5, 1946).

284. See *supra* notes 230–34 and accompanying text.

While the creation of a merged legal system would be a timely process controlled by legislative action, the process can begin immediately with the reform of governance practices within corporations.<sup>285</sup> Beginning immediately, U.S. corporations can include the applicable shareholder protection provisions in their articles of incorporation on a “comply or explain” basis, thus creating structural and shareholder-oriented changes within the corporation.<sup>286</sup> The provisions could be tailored to the specific corporations, and thus would be more effective than a “comply or else” approach that is present and must be followed by all corporations in the United States today.<sup>287</sup> As a comply or explain approach, the corporation would be able to deviate from the provisions as long as it was in the best interest of the shareholders.<sup>288</sup> If the corporation did find it necessary to deviate, it would be required to release a public statement explaining the deviation.<sup>289</sup> In order for this to work properly, the activist shareholders and normal shareholders would need to work together to monitor the corporations and ensure that the deviation was, in fact, in the best interest of the shareholders.<sup>290</sup> Assuming that the corporations would either comply or choose to make other shareholder beneficial decisions, the approach would undoubtedly be a success.

The success of corporations that implement the shareholder friendly governance practices would then increase the odds of creating a true legally merged system.<sup>291</sup> This is because the shareholders that benefit will “create an interest group to press for reforming corporate governance to encourage value-enhancing practices.”<sup>292</sup> In other words, after gaining benefits within corporations with altered corporate governance policies, shareholders will undoubtedly come together to press for gradual changes that will mimic the changes already implemented within the complying corporations.<sup>293</sup>

When the time comes for the shareholders to push for a legal convergence, the argument for reform should be modeled on the Brazil-

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285. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law* 1, 17 (Yale Law Sch., Working Paper No. 235, 2000), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=204528](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=204528).

286. *Id.* at 2–3.

287. Subrata Sarkar, *The Comply-Or-Explain Approach for Enforcing Governance Norms* 1–2 (Indira Gandhi Inst. of Dev. Research, Working Paper No. WP-2015-022, 2015), <http://www.igidr.ac.in/pdf/publication/WP-2015-022.pdf>.

288. *Id.* at 4.

289. *Id.* at 6–8.

290. *Id.*

291. Hansmann & Kraakman, *supra* note 285, at 17, 25–26.

292. *Id.* at 25–26.

293. *Id.* at 18.

ian Stock Exchange reform of 2000.<sup>294</sup> There, in order to better protect investors while also aiming to increase the capital market's value, Brazil implemented a "dual regulatory regime," in which corporations were allowed to choose from four levels of listing requirements with shareholder protection increasing at each level.<sup>295</sup> The system allowed each corporation to choose the requirement that best fit its needs while still protecting shareholders at each level and attracting new sources of capital.<sup>296</sup> Although a system such as this cannot be put into place over night, it is the best way to ensure that corporate America is the greatest that it can be, as corporations could choose from a varying degree of shareholder friendly policies in order to suit the needs of their business. By slowly transitioning to a merged corporate governance system, average shareholders and activist shareholders would be given more power and be better able to communicate with corporations to generate changes to improve all involved parties. The next Part discusses how each party would benefit from these changes in the corporate governance system.

#### IV. IMPACT

Corporate governance is at the center of some of the country's most important issues.<sup>297</sup> It affects the creation and distribution of wealth, it influences social mobility, stability, and fluidity, as well as social security and retirement plans.<sup>298</sup> In other words, corporate governance laws touch on most of the issues that activist shareholders seek to change.<sup>299</sup> For that reason, U.S. shareholders, including those that are activists, must be well informed because "[a]n informed shareholder is the best visionary, planner and evaluator an organization can count on."<sup>300</sup> Offering feedback on proposed ideas, discussing new strategies, and providing insight into the day-to-day management operations will ensure shareholder involvement.<sup>301</sup> If the American activists are better informed due to the implementation of the applica-

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294. Aguilera et al., *supra* note 109, at 28.

295. *Id.*

296. *Id.*

297. GOUREVITCH & SHINN, *supra* note 71, at 3.

298. *See id.*

299. Activists push for changes in company's leadership and business practices. *See* Stevenson, *supra* note 7.

300. Nitin Mamillapally, *Shareholders or Stakeholders – Who Is More Important?*, LINKEDIN (Jun. 19, 2014), <https://www.linkedin.com/pulse/20140619213822-24445561-shareholders-or-stakeholders-who-is-more-important>.

301. *Id.*

ble sections of the UK Codes, they will be able to generate great changes that benefit both shareholders and corporations at large.

This can be accomplished effectively through a “hybrid governance regime.”<sup>302</sup> By combining the UK shareholder-friendly policies with the strict, mandatory regulation schemes already in place in the United States, activists would be able to work hand-in-hand with shareholders more easily. In doing so, activists would then be able to generate changes that benefit shareholders and the corporations in which they invest.<sup>303</sup> With this power, activists will no longer need to look abroad for business opportunities, as they will have all of the necessary tools to enact change in their home country.<sup>304</sup> By working within a merged, hybrid corporate governance system, activist shareholders would be better suited to ensure that shareholder value would be of great importance within corporations. However, not only shareholders would benefit under this regime, because corporations would excel alongside of their shareholders.<sup>305</sup> This notion is further discussed in the following Sections.

### A. Shareholders Will Reap More Benefits

When activists buy shares in a corporation, they seek to make changes in management and in the boardroom that benefit all shareholders.<sup>306</sup> Activists have the ability to make changes that will move a company in a new direction as long as the company’s other shareholders agree that the changes are desirable and beneficial.<sup>307</sup> When shareholders’ voices are restricted, this is a difficult task. However, by

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302. Anand, *supra* note 110, at 232.

303. Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 123, at 842–43 (“I do not view increasing shareholder power as an end in and of itself. Rather, effective corporate governance, which enhances shareholder and firm value, is the objective underlying my analysis. From this perspective, increased shareholder power would be desirable only if it would operate to improve corporate performance and value.”).

304. Aguilera et al., *supra* note 109, at 2 (“Effective corporate governance entails mechanisms to ensure executives respect the rights and interests of company stakeholders, as well as guarantee that stakeholders act responsibly with regard to the generation, protection, and distribution of wealth invested in the firm.”).

305. Matt Krantz, *Activist Investors Often Cause More Good than Harm*, USA TODAY (May 3, 2016, 8:30 AM), <http://www.usatoday.com/story/money/markets/2016/05/03/activist-investors-often-cause-more-good-than-harm/83841952/> (“Activists, and companies that adopt activist thinking, often focus on improving their return on invested capital. This is a financial measure that tells you how much profit is driven out of the money entrusted to the company by investors.”).

306. Bret Kenwell, *Nelson Peltz – Activist Investors Benefit All Shareholders*, THESTREET (Apr. 2, 2015, 3:23 PM), <https://www.thestreet.com/story/13100807/1/nelson-peltz—activist-investors-benefit-all-shareholders.html>.

307. Bebchuk & Jackson, *supra* note 183, at 50.

allowing activists to work closely with other shareholders, activists' success rates in altering the corporation's governance structure and increasing shareholder wealth would soar.<sup>308</sup> By working together, activists and shareholders would be better able to address governance flaws more successfully.<sup>309</sup> This would cause directors and officers to be more accountable to shareholders, thus allowing for an increase in shareholder benefits.<sup>310</sup>

In a time where companies are holding more cash on their balance sheets than ever before, activists are fighting for corporations to give the money back to shareholders through dividend payments and share buybacks.<sup>311</sup> For this reason, activists are considered "rock stars" who are both advocates and "watchdogs" for all shareholders.<sup>312</sup> In 2013, for example, activists returned eighteen percent back to shareholders, compared to the average nine percent seen throughout the rest of the corporate market.<sup>313</sup> This percentage of return can grow even larger if the U.S. is exposed to a merged corporate governance system. Activists abroad have been extremely successful in positively influencing share values through corporate governance practices that increase shareholder participation.<sup>314</sup> By creating a hybrid governance system, the United States could adopt the same ideals and thereby create the same effects, further enhancing the U.S. capital market as a whole.

### B. *More Change Leads to More Value for Corporate America*

Ensuring shareholders' satisfaction by giving them greater power is important, but it is not the "end game."<sup>315</sup> Shareholders will undoubtedly receive better benefits with more help from shareholder activists,<sup>316</sup> but the value of the targeted firms will also increase as

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308. Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227, 251 (1996) ("[E]vidence indicates that shareholder activism is largely successful in changing governance structure and, when successful, results in a statistically significant increase in shareholder wealth.").

309. Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 123, at 913.

310. Fairfax, *supra* note 277, at 3.

311. Rana Foroohar, *Shareholder 'Activists' – Are They Good Or Bad?*, TIME (Mar. 26, 2014), <http://time.com/38487/shareholder-activists-are-they-good-or-bad/>. Apple, for example, had a cash hoard of nearly \$200 billion in 2015. Sarah Whitten, *Just How Much Cash Does Apple Have?*, CNBC (Oct. 28, 2015, 10:16 AM), <http://www.cnbc.com/2015/10/28/just-how-much-cash-does-apple-have.html>.

312. Nathan Vardi, *The Golden Age of Activist Investing*, FORBES (Aug. 6, 2013, 8:25 AM), <http://www.forbes.com/sites/nathanvardi/2013/08/06/the-golden-age-of-activist-investing/>.

313. Stevenson, *supra* note 7.

314. Fairfax, *supra* note 277, at 3.

315. Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 123, at 842–43.

316. See *supra* notes 306–14 and accompanying text.

well.<sup>317</sup> Prior to 1994, most evidence showed that activist shareholders had a minimal effect on overall firm performance; however, recent studies find that shareholders and activists, when working together, are associated with a positive long-term effect in corporations.<sup>318</sup> In fact, “proposals sponsored by blockholders have a large measured effect on nearly all aspects of firm performance.”<sup>319</sup>

While the benefits created by activists are prevalent in the United States already, they may cease to exist if activists continue to move abroad. The addition of the shareholder friendly UK policies will keep activists in the U.S. and will lead to even more beneficial changes in corporate America. In the UK, direct communication between shareholders and management is very common, causing companies to open themselves up to activist shareholder engagement.<sup>320</sup> The added UK policies would allow for the communication lines to not only open between activists and other shareholders, but also between activists and U.S. corporations’ management. American activists would then be able to successfully use a “suggestivist” approach when attempting to enact changes.<sup>321</sup> Instead of launching aggressive campaigns and potentially embarrassing the CEOs of corporations, activists would act as “suggestivists” by cordially discussing their plans with corporations’ management.<sup>322</sup> Activist engagement occurs in the UK by using this approach to influence corporations rather than using legal threats and confrontational practices.<sup>323</sup> By following this tactic, U.S. activists can work hand-in-hand with shareholders and the companies’ boards alike to affect changes.

A study conducted at the London Business School found a “high correlation between enhanced firm value and shareholder activism.”<sup>324</sup> The authors noted that the correlation between value and

317. Bebchuk, *The Case for Increasing Shareholder Power*, *supra* note 123, at 842–43.

318. Bonnie G. Buchanan et al., *Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and the United Kingdom*, 49 AM. BUS. L.J. 739, 746 (2012) (“[I]mprovement is greater when shareholder proposals are sponsored by blockholders.”).

319. *Id.* at 788.

320. John Hendry et al., *Responsible Ownership, Shareholder Value and the New Shareholder Activism* 1, 8 (Univ. of Cambridge ESRC Ctr. for Bus. Research, Working Paper No. 297, 2004), [http://www.cbr.cam.ac.uk/fileadmin/user\\_upload/centre-for-business-research/downloads/working-papers/wp297.pdf](http://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp297.pdf).

321. Vardi, *The Golden Age of Activist Investing*, *supra* note 312.

322. *Id.*

323. Kate Burgess, *Confrontational Activism Rare in the UK*, FIN. TIMES (Jan. 3, 2016, 2:23 PM), <http://www.ft.com/intl/cms/s/0/d39997a0-a3f2-11e5-8218-6b8ff73aae15.html#axzz3zVkXpCw8>.

324. Fairfax, *supra* note 277, at 25. See generally Marco Becht et al., *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK Focus Fund*, 22 REV. FIN. STUD. 3094 (2009).

activism is not as prevalent in the United States because of the poor current governance mechanisms currently set in place.<sup>325</sup> However, reforming the U.S. governance system to incorporate the UK policies that are more favorable for activism will increase the chance that activism will have an even greater positive impact on targeted corporations.<sup>326</sup>

Opponents have continuously overlooked the evidence that shareholder activism can, and does, improve target companies' operations.<sup>327</sup> Opponents are greatly concerned with the activist's push for higher dividend payments, arguing that the higher payment could leave a corporation with fewer resources for future investments.<sup>328</sup> However, "opponents . . . overlook that reducing cash holdings and investments might actually move companies closer to, rather than away from, the levels that are optimal for the long term."<sup>329</sup> When a company issues a dividend payment that is higher than expected, the company's stock prices increase as investors become interested that the company is perhaps growing.<sup>330</sup> Although issuing dividend payments means that money is leaving a corporation, the payments attract more investors.<sup>331</sup> This essentially allows the company to earn back what it has lost through new investors.<sup>332</sup> When looking at the impact in such a way, it is clear that increasing dividend payments also increases firm value.<sup>333</sup>

In looking beyond the effects of dividend payments, several commentators published a study that documented a positive seven percent stock return after filing a disclosure statement that an activist was investing in a company.<sup>334</sup> Although disclosure laws have at times

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325. Becht et al., *supra* note 324, at 3094.

326. *Id.*

327. Jonathan M. Karpoff, *The Impact of Shareholder Activism on Target Companies: A Survey of Empirical Findings 4* (Aug. 18, 2001) (unpublished manuscript), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=885365](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=885365).

328. Bebchuk et al., *The Long-Term Effects*, *supra* note 29, at 1136.

329. *Id.*

330. *How Dividends Affect Stock Price*, SCOTTRADE (Jul. 1, 2014), <https://about.scottrade.com/blog/blogposts/How-Dividends-Affect-Stock-Price.html>.

331. *Id.*

332. *Id.*; Claire Boyte-White, *How Dividends Affect Stock Prices*, INVESTOPEDIA (Sept. 10, 2015, 11:15 AM), <http://www.investopedia.com/articles/investing/091015/how-dividends-affect-stock-prices.asp> ("When companies display consistent dividend histories, they become more attractive to investors. As more investors buy in to take advantage of this benefit of stock ownership, the stock price naturally increases, thereby reinforcing the belief that the stock is strong. If a company announces a higher-than-normal dividend, public sentiment tends to soar.").

333. Fairfax, *supra* note 277, at 3.

334. Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729 (2008).



harmed activist campaigns, this suggests that shareholders, as well as potential future shareholders, believe that activist campaigns create value in their target companies.<sup>335</sup> These shareholders are correct, as “target firms experience increases in payout, operating performance, and higher CEO turnover after activism.”<sup>336</sup> These benefits are not short term, as some suggest, as in the five-year period after the activist intervention the gains continue to exist.<sup>337</sup>

Because shareholders directly affect the “health and efficient functioning of U.S. capital markets,” it is problematic that U.S. shareholders have fewer rights than most other foreign shareholders.<sup>338</sup> While the benefits that corporate America has already experienced due to activist campaigns is significant, even larger and more important benefits can be achieved if the U.S. creates a merged corporate governance system. However, if more rights are not given to shareholders and the investors who fight for them, it is likely that activists will continue to launch more campaigns abroad, eventually leaving the American markets behind completely. In order to avoid their departure, it is vital to remember the benefits that activists bring forth and make changes to the corporate governance system accordingly.

## V. CONCLUSION

While the UK corporate governance system as a whole would not be an adequate fit in the United States,<sup>339</sup> the United States should incorporate a subset of its policies into its own corporate governance system. By implementing the fifth and sixth principles of the UK Stewardship Code, as well as Section E.1 and E.2 of the UK Corporate Governance Code, into the current U.S. regulatory scheme, activist shareholders will have access to all of the tools in which they need to generate beneficial changes. The merged governance system will allow activists to work closely with corporations’ shareholders and board members in order to enhance both the shareholders’ and corporations’ values. Carl Icahn was able to raise Apple’s market value by \$18 billion using less than a mere 280 characters in a country that has proven to be shareholder unfriendly. With a merged corporate governance system created from the finest UK and U.S. governance poli-

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335. *Id.*

336. *Id.*

337. John Carney, *Welcome to the Golden Age of Activist Investors*, CNBC (Aug. 14, 2013, 3:37 PM), <http://www.cnbc.com/id/100963166>.

338. COMM. ON CAPITAL MKT. REGULATION, INTERIM REPORT 1, 16 (2006), <http://www.cpmktsreg.org/wp-content/uploads/2014/08/Committees-November-2006-Interim-Report.pdf>.

339. See generally Ashar Qureshi, *Rights Issues: Why US Shareholders Are Not Always Welcome* 22 INT’L FIN. L. REV. 37 (2003).

cies, Icahn and other activist investors will be able to bring forth even more beneficial changes in corporate America. That possibility should excite shareholders and corporations alike.

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